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Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

AMERICAN PUBLIC GAS ASSOCIATION,
Petitioner

v.

FEDERAL POWER COMMISSION,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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Petitioner American Public Gas Association ("APGA") petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals is reported at 520 F.2d 1061 and its *per curiam* order denying rehearing is reported at 525 F.2d 1261. These decisions are set forth in Appendices A and B, respectively, of the Appendix to Petition for Certiorari of California Company, A Division of Chevron Oil Company.[1] The initial

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[1] In the interest of simplicity, each party filing a petition for certiorari has agreed to utilize the appendix of California Company for the reprinting of the opinions of the court of appeals and of

[Footnote continued]

order (Opinion No. 699) of the Federal Power Commission ("FPC" or "Commission") and its order (Opinion No. 699-H) denying rehearing are set forth in Appendices C and D, respectively.

JURISDICTION

The judgment of the court of appeals (Appendix A) was entered on October 14, 1975. On January 5, 1976, Justice Powell extended APGA's time for filing a petition for writ of certiorari to and including March 12, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b).

QUESTIONS PRESENTED

1. Whether the Federal Power Commission erred in establishing a national rate for new natural gas without holding an evidentiary hearing on the complicated factual issues involved in such a decision in view of (1) the requirement of "full hearings" contained in Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. § 717c and d, (2) the requirement of "substantial evidence" contained in Section 19(b) of the Act, 15 U.S.C. § 717r(b), (3) the right of "cross-examination" contained in Section 1.20(g)(1) of the FPC's Rules of Practice and Procedure, and (4) the fact that the rate set without a hearing doubles the area rate approved by this Court in *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283 (1974), which was based on a full evidentiary hearing record.

2. Whether the Court of Appeals erred in utilizing a less demanding "kid glove" review standard by which it

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[1] [Continued]
the Federal Power Commission which are the subject of this petition and of the relevant sections of the Natural Gas Act, 15 U.S.C. § 717, *et seq.*, denominated as Appendices A through E. APGA has attached additional appendices to the instant petition, denominated as Appendices F and G.

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upheld the arbitrary actions taken by the Commission, *inter alia*, (1) of permitting admittedly low cost, "flowing" gas to receive the "new" gas rate if the original contract has expired and a renewal contract has been executed and one of these events occurred on or after January 1, 1973, (2) of abandoning the cost methodology approved by this Court in *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), in favor of the untested discounted cash flow ("DCF") methodology, (3) of approving an admittedly understated net liquid credit, and (4) of utilizing admittedly unreliable, understated industry-supplied reserve data to determine the appropriate productivity figure, none of which actions were supported by "substantial evidence" in the record as required by Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b).

3. Whether the Federal Power Commission erred in permitting the national rate for new gas to be collected for the sale of flowing gas where fortuitously the original contract has expired and a renewal contract has been executed, one of which must have taken place on or after January 1, 1973, since such occurrences are irrelevant and since there is no record evidence of any cost increase above prior fully-adjudicated levels for such flowing gas, thereby in effect accomplishing a limited *de facto* deregulation of gas without complying with the standards of the Natural Gas Act for "just and reasonable" rates.

STATUTES INVOLVED

Sections 4, 5, 7, and 19 of the Natural Gas Act, 15 U.S.C. §§ 717c, d, f, and r, are set forth in Appendix E. Sections 553, 556, 557, and 706 of the Administrative Procedure Act ("APA"), 5 U.S.C. §§ 553, 556, 557, and 706 are set forth in Appendix F, *infra*.

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STATEMENT

1. The present case involves the largest rate increase to American consumers ever granted in the history of the United States and the first to be made without an evidentiary hearing. On April 11, 1973, the FPC issued a "Notice of Proposed Rulemaking and Order Prescribing Procedures" stating, *inter alia*, its intent to set a single uniform nationwide rate for new natural gas based upon untested submittals without benefit of trial-type adjudicatory procedures, which had been the basis for every Section 4 and 5 ratemaking proceeding since the inception of the Natural Gas Act in 1938.[2] Under the informal rulemaking procedures, APGA was limited to filing initial and reply comments on May 16, 1973 and June 1, 1973 in which it vigorously contended that an evidentiary hearing with cross-examination was necessary, not only because the Natural Gas Act required such a proceeding, but also because, as a practical matter, since all of the necessary data on costs and reserves, which are absolutely essential to setting the "just and reasonable" rates mandated by Section 4 of the Natural Gas Act, are peculiarly and exclusively in the hands of the natural gas producers, i.e., the regulated industry, APGA and other consumer representatives would be unable to effectively challenge the data which the producers chose to present without the right to test such information through cross-examination.

On March 21, 1974, the Commission issued a "Notice of Issuance of Revised Staff Nationwide Cost Study and Staff Study of American Gas Association Reserve Additions."[3] In this study, the Staff, after reviewing data on only 31 selected leases, found 1.7 trillion cubic feet (Tcf) *more* gas in these 31 leases than was re-

[2] J.A. at 1-97. (J.A. refers to the Joint Appendix filed with the Court of Appeals below.)

[3] J.A. at 126-176.

ported by the American Gas Association ("AGA") as the total non-associated gas reserve additions for the more than 870 offshore Southern Louisiana leases for 1971 and 1972.[4] As a result of this finding, the Staff concluded that the reserve additions reported by AGA were understated by at least 54 percent.[5]

On June 21, 1974, just 11 days after this Court had rendered its decision in *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283 (1974), affirming a just and reasonable 26¢/Mcf area rate for new gas (with a 1¢ escalation in 1974 and a moratorium through 1977) and flowing gas rates of 22.275¢/Mcf and 21.3754 Mcf for onshore and offshore gas, respectively, the Commision issued Opinion No. 699 (App. C) in which it set a nationwide new gas rate of 42¢, with 1¢ per Mcf annual escalations, based on the untested industry data. In so doing, the Commission used the AGA reserve data on a nationwide basis despite its Staff's findings of a more than 50 percent under-reporting of such data in its spot check investigation.

Rehearing was denied by the Commission in Opinion No. 699-H (App. D), issued on December 4, 1974, in which it increased the nationwide rate from 42¢ to 50¢ based primarily on a methodology (i.e., the discounted cash flow approach) which it had expressly rejected in Opinion No. 699 as unworkable and unreliable, as well as unprecedented, and the Commission applied this 50¢/Mcf rate to *flowing* gas if fortuitiously the initial contract term had ended and a renewal contract was executed, and one of these events had occurred on or after January 1, 1973.

2. APGA filed its petition for review in the District of Columbia Circuit on December 4, 1974, which petition was later transferred to the Fifth Circuit. There-

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[4] J.A. at 166-167.

[5] *Id.*

after, on October 14, 1975, the Fifth Circuit, utilizing what it described as a "kid glove" standard of review, affirmed Opinion Nos. 699 and 699-H in their entirety (App. A at A-16-19). The court of appeals concluded, *inter alia*, (1) that no evidentiary hearing was required under the Administrative Procedure Act, but did not mention the procedural requirements of the Natural Gas Act (App. A at A-24-25); (2) that the new gas rate could be applied to flowing gas at the end of the initial contract term if a renewal contract had been entered into and if either the initial contract expired and/or the renewal contract was executed on or after January 1, 1973, even though contract expiration and renewal dates are irrelevant since the flowing gas must continue to be sold to the interstate market until Section 7(b) abandonment approval is obtained from the FPC (App. A at A-29-A-30); (3) that the net liquid credit, the one cost component which reduces the rate approved by the Commission, of 3.89¢/Mcf had sufficient record support even though the Commission admitted that the figure was understated (App. A at A-41; App. C at C-102); and (4) that the utilization of the DCF cost methodology was proper even though the FPC had rejected its use in Opinion No. 699 stating that its adoption would be "irresponsible" and had then made a complete about-face in Opinion No. 699-H, with no additional evidence before it, and approved the DCF methodology (App. A at A-36-A-37; App C at C-95, C-100; App. D at D-15-16).

REASONS FOR GRANTING THE WRIT

1. The decision of the court of appeals to uphold the FPC's utilization of informal rulemaking procedures to set "just and reasonable" rates under the Natural Gas Act conflicts with the opinion of the District of Columbia Circuit in *Mobil Oil Corp.* v. *FPC*, 157 U.S. App. D.C. 235, 483 F.2d 1238 (1973), and is contrary to the explicit language of Sections 4, 5 and 19(b) of the Natu-

ral Gas Act, 15 U.S.C. §§ 717c, d and r(b) (App. E at E-1-4, E-9-10), which require "full hearings" resulting in "substantial evidence" in the record, and of Section 1.20(g)(1) of the Commission's Rules of Practice and Procedure (App. G, *infra*), which mandates that all parties "shall have the right of . . . cross examination" in hearings before the FPC.

The court of appeals below found that the FPC by permitting only the informal rulemaking procedures of Section 553 of the APA, 5 U.S.C. § 553 (App. F, *infra*), of initial and reply comments and by holding oral argument after Opinion No. 699 was issued (App. C at C-16; App. D at D-6-7) had complied with all procedural requirements (App. A. at A-24-25). It reached this conclusion without making any reference to the language of the Natural Gas Act or the Commission's Rules.

As noted above, the Natural Gas Act, i.e., the substantive statute, requires that when rates are set, "full hearings" must take place and these hearings must yield "substantial evidence" to support any Commission action in a ratemaking proceeding. As we show below, this statutory standard is the equivalent of a "hearing on the record" which this Court held in *United States* v. *Florida East Coast Railway Co.*, 410 U.S. 224, 238 (1973),[6] would trigger the hearing provisions of the Administrative Procedure Act, 5 U.S.C. §§ 556 and 557 (App. F, *infra*).

Section 553(c) of the APA (App. F, *infra*), which

[6] This Court upheld the Interstate Commerce Commission's use of the informal rulemaking procedures of Section 553 of the APA in *Florida East Coast Railway*. However, the statute there under review required only that "the Commission shall give *consideration* to" various aspects of the railroad industry. The question on review was solely whether the ICC "considered" all of the factors it was supposed to in making its determination. The much more stringent requirement of "substantial evidence" was not involved, and therefore informal rulemaking procedures were deemed adequate. *See* Mobil Oil Corp. v. FPC, 483 F.2d at 1260-61.

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sets forth the informal rulemaking procedures followed by the FPC in the instant case, states that "[w]hen rules are required to be made on the record after opportunity for an agency hearing, Sections 556 and 557 of this title apply instead of this subsection." That the Natural Gas Act, as a substantive statute calling for full hearings with substantial evidence, contains the equivalent of the hearing on the record standard is confirmed by the language of Section 706(2)(E) of the APA, 5 U.S.C. § 706(2)(E) (App. F, *infra*):

> The reviewing court shall— . . . hold unlawful and set aside agency action, findings, and conclusions found to be— . . . *unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute* . . . . [Emphasis supplied.]

Utilizing this reasoning, the D.C. Circuit in its *Mobil* decision held that the "substantial evidence" test, being a part of the actual language of the Natural Gas Act, as well as part of the APA, conclusively showed that Congress demanded a high degree of certainty concerning the facts upon which the FPC bases its ratemaking decisions,[7] and that court found that the "substantial evidence" requirement could not be satisfied under the informal rulemaking procedures of Section 553 of the APA.[8] Accordingly, the D.C. Circuit reached a conclusion completely opposite to that of the Fifth Circuit in the present proceeding:

> Informal comments simply cannot create a record that satisfies the substantial evidence test. Even if controverting information is submitted in the form of comments by adverse parties, the procedure employed cannot be relied upon as adequate. A "whole record," as that phase is used in this context, does

[7] 483 F.2d at 1257-58.

[8] *Id.* at 1259.

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> not consist merely of the raw data introduced by the parties. It includes the process of testing and illumination ordinarily associated with adversary, adjudicative procedures. Without this critical element, informal comments, even by adverse parties, are two halves that do not make a whole. Thus, it is adversary procedural devices which permit testing and elucidation that raise information from the level of mere inconsistent data to evidence "substantial" enough to support rates.[9]

Thus, it is not the APA which requires adversary procedures in this proceeding, but the Natural Gas Act's full hearings and substantial evidence requirements. The substantive statute determines *if* a party is entitled to an evidentiary hearing; the APA only tells which procedures such a proceeding must contain. As noted above at page 7, footnote 6, this Court concluded in *Florida East Coast Railway* that an evidentiary hearing was not there required because the substantive statute involved only provided that "consideration" be given by the ICC to various aspects of the railroad industry before a new rule is promulgated.

And in opinions rendered before the APA was passed by Congress, this Court held that the substantive statute controlled the right to an evidentiary hearing. For example, *Morgan* v. *United States*, 298 U.S. 468, 477-78 (1936), involved the Packers and Stockyards Act, 7 U.S.C. §§ 181-229, which required a "full hearing"; as a result, this Court held that "the statute itself demands a full hearing and the order is void if such a hearing was denied." This same conclusion was reached in *Interstate Commerce Commission* v. *Louisville & Nashville R.R. Co.*, 227 U.S. 88, 91-93 (1913), which concluded that when a full hearing is required by a substantive statute, an evidentiary record must be compiled and cross-examination must be permitted. With the enactment of

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[9] *Id.* at 1260.

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the APA, the minimum required procedural *content* of an evidentiary hearing was codified in Sections 556 and 557 thereof, but the *right* to a hearing emanates from the substantive statute, which in the present case is the Natural Gas Act and its requirement of "full hearings" and "substantial evidence."

However, if an agency through its own rules guarantees greater procedural rights than the APA or even the substantive enabling statute requires, those rules have the force of law, and the agency is bound to follow them. This Court has so held in a number of opinions beginning with *United States ex rel. Accardi* v. *Shaughnessy*, 347 U.S. 260, 265-68 (1954), and *Service* v. *Dulles*, 354 U.S. 372, 388 (1957), and has most recently reaffirmed this conclusion in *United States* v. *Nixon*, 418 U.S. 683, 694-96 (1974).[10] Thus, even assuming *arguendo* that the "full hearings" and "substantial evidence" standards of the Natural Gas Act do not require an evidentiary hearing to be held, the FPC is still bound to hold an adversary hearing under Section 1.20(g)(1) of its Rules of Practice and Procedure (App. G, *infra*) which governs hearings and which states that "[p]arties . . . shall have the right of presentation of evidence, [and] cross examination. . . ."

The need for an evidentiary hearing is especially great in this proceeding in which the largest multi-billion dollar increase in the nation's history in producer rates was granted by the FPC through the arbitrary use of untested assumptions and methodologies which differ markedly from those approved on review of complete evidentiary records by this Court in *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283 (1974), and *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), and utilized in all prior area rate proceedings. In fact, in *Mobil*, decided just 11

[10] *Accord*, Morton v. Ruiz, 415 U.S. 199, 235 (1974); Yellin v. U.S., 374 U.S. 109, 120-24 (1963); Vitarelli v. Seaton, 359 U.S. 535, 539-40 (1959).

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days before the FPC issued Opinion No. 699 permitting a 42¢/Mcf rate, which was later raised to 50¢/Mcf in Opinion No. 699-H, this Court found just and reasonable (1) a 26¢/Mcf new gas rate with a 1¢ escalation in 1974, (2) lower rates for all flowing gas and (3) in the Southern Louisiana Area, moratoria on rate increases for new gas until October 1, 1977 and for flowing gas until October 1, 1976.[11]

Furthermore, the most important factor in the FPC's doubling of the rate approved in *Mobil* was its drastic reduction of the productivity figure which it based entirely on industry-supplied data including the AGA reserve data that the Commission Staff found to be understated by a minimum of 54 percent.[12] Even though the FPC agreed with the Staff's finding of significant understatement, it made only a 1.7 Tcf upward adjustment in the AGA reserve figure and accepted the remaining industry-provided data at face value (App. C at C-55-56, C-60-61)). This blind acceptance of whatever data the producers wish to provide in a situation where all of the relevant information is peculiarly and exclusively within the producers' possession, only serves to underscore the importance of permitting all parties to test and question this data through cross-examination of industry witnesses. Since consumers have no independent access to industry data, cross-examination is, as a practical matter, the only tool they have for getting at the truth.

2. The court below erred in not following the standard of review set by this Court in its prior Area Rate cases. Because there was no evidentiary hearing before the Commission in the instant case and only informal rulemaking procedures were followed, substantial evidence in the record is completely lacking to support Opinion Nos. 699 and 699-H. However, Section 19(b) of the Natural Gas Act requires substantial evidence for

[11] 417 U.S. 298-299.

[12] J.A. at 166-167.

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affirmance on review. As this Court held in *Mobil* and *Permian*, the court of appeals "must decide whether each of the order's essential elements is supported by substantial evidence." [13]

Thus, the court of appeals was forced to adopt a lesser standard of review than the substantial evidence test required by the Natural Gas Act in order to affirm the FPC's orders. The court of appeals admitted that but for the "kid glove" standard of review it was utilizing, Opinion Nos. 699 and 699-H would have to be set aside:

> We must express our regret, however, that the FPC continues to issue orders which would be inadequate but for our "kid glove" treatment. . . . Just as we must consider individual elements in our review of an FPC order to insure that it is supported by substantial evidence, so should the Commission examine the effect of each when it is deciding how to compose the rate structure initially. For over fourteen years the Commission has been experimenting in area rate regulation and yet it still "supports" many of the essential elements of its new national rate order with little more than *ipse dixit*. [App. A at A-19.]

One of the individual elements which could not have passed muster on review without the use of the "kid glove" review standard was the FPC's sudden adoption of the discounted cash flow ("DCF") methodology in Opinion No. 699-H, which accounted for the 8¢/Mcf increase to 50¢/Mcf therein (App. D at D-36-37) from the 42¢/Mcf level set in Opinion No. 699, where DCF costing had been rejected for lack of evidentiary support. Although the DCF had never before been utilized, the court of appeals stated that it would not "delv[e] into the complexities of an esoteric costing methodology which counsel could scarcely describe in their briefs or at oral

[13] 417 U.S. at 309-10; 390 U.S. at 791-92.

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argument." (App. A at A-36). Instead, the Court summarily accepted this new costing methodology which differed from that formulated after full evidentiary hearings and affirmed by this Court in both *Permian* and *Mobil*.

Obviously, the "complexities of an esoteric costing methodology" could be much better understood and supported or challenged if evidentiary hearings had been held to explore the propriety of adopting the DCF methodology. Instead, we are left with the spectacle of the Commission rejecting the DCF costing format in Opinion No. 699 because "[w]e are bound by the record that is before us, which lacks the necessary information for a reliable DCF cost estimate" (App. C at C-95) and "we believe that for the Commission to depart from the costing methodology it has used in all previous producer rate cases would be irresponsible at this final rulemaking stage" (*Id.* at C-100). Then, in Opinion No. 699-H, even though no additional evidence had been placed in the record, the Commission reversed its Opinion No. 699 conclusion and adopted the DCF methodology on the ground that "[w]e find that supplementary cost analysis necessary to assure that the rate allowed for new gas supplies adequately reflects the true cost of those supplies." (App. D at D-15). The FPC never attempted to explain what evidence it found in the record to support this 180° change in position, but the court of appeals affirmed the use of DCF costing anyway under the "kid glove" standard of review.

The one cost element which reduces the rate is the net liquid credit. In Opinion No. 699, the FPC set the net liquid credit at 3.89¢/Mcf on the basis of AGA data even though it admitted that "the recent increases in the prices paid for condensate cause this component of the cost analysis to be understated" (App. C at C-102). Having refused to hold an evidentiary hearing, the Com-

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mission had no evidence upon which to set a proper net liquid credit, and the court of appeals conceded that "there is some merit in the charge that the evidence supporting the level [of the net liquid credit] set by the Commission is thin" (App. A at A-41). Nevertheless, once again utilizing "kid glove" review, the court of appeals approved of a Commission conclusion for which "substantial evidence" is lacking.

The "kid glove" standard of review applied by the Fifth Circuit was made "necessary" in this case because informal rulemaking procedures failed to compile a record to meet the substantial evidence requirement of Section 19(b) of the Natural Gas Act. The present case thus provides clear proof of the correctness of the conclusion of the D.C. Circuit in *Mobil Oil Corp.* v. *FPC*, 157 U.S. App. D.C. 235, 483 F.2d 1238, 1260 (1973), which the court of appeals below refused to follow (App. A at A-24), that

> Informal comments simply cannot create a record that satisfies the substantial evidence test . . . . Thus, it is adversary procedural devices which permit testing and elucidation that raise information from the level of mere inconsistent data to evidence "substantial" enough to support rates.

3. APGA also submits that the court of appeals' affirmance of the FPC's arbitrary abandonment, without any hearing, of the dual rate structure approved by this Court after full evidentiary hearings in *Permian* and *Mobil* for "new" and "flowing" gas must be reversed. Flowing gas costs are virtually all sunken and are therefore lower than new gas costs, but under the FPC's orders, flowing gas qualifies for the new gas rate when the original contract expires and a renewal contract is entered into, if one of these events occurs after January 1, 1973. Hence, the oldest, lowest cost flowing gas will be the first to qual-

ify for the new gas rate since these contracts will expire first.[14]

The stated purpose of this non-cost based, giant increase in rates for flowing gas is to provide an incentive to producers to expend more funds for exploration and development. However, by definition, there can be no incentive to produce and sell flowing gas to the interstate market since it is already being sold to interstate consumers and such sales may not be abandoned without the approval of the FPC in an abandonment proceeding under Section 7(b) of the Natural Gas Act, 15 U.S.C. § 717f (b) (App. E at E-5).

Since the Commission has attached no requirement that all or even any part of the monies collected above the present flowing gas rates must be invested solely in exploration and development for natural gas which must be dedicated to the interstate market, the producers are simply the recipients of windfall profits as beneficiaries of partial deregulation of the type struck down by this Court in *Federal Power Comm'n* v. *Texaco Inc.*, 417 U.S. 380 (1974). In that case, a Commission attempt to completely deregulate small producers was reversed because the unregulated rates would not be "just and reasonable". Here, partial deregulation up to a 52¢/Mcf rate is being permitted for all producers selling flowing gas under renewal contracts with no showing in this record

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[14] Any producer which requires special relief because its flowing gas costs exceed the applicable area flowing gas rate may apply for such relief under Section 2.76 of the Commission's General Policy and Interpretations, 18 C.F.R. § 2.76. However, under this section, the producer must not only prove excess costs, but must also show that an increase in gas supply will result from the grant of an increased price. Neither of these two criteria need be met to obtain the new gas rate for flowing gas under Opinion No. 699-H. Instead, the producer need show only the completely irrelevant occurrences of contract expiration and renewal, one of which must have occurred on or after January 1, 1973.

of any increase in flowing gas costs above the approximately 22¢/Mcf rate approved by this Court in *Mobil*.[15]

Permitting flowing gas to obtain the new gas rate without at the very least requiring that the excess profits received by the producers be expended on exploration for interstate gas supplies is contrary to this Court's holding in *Permian* that the rate set must be "the lowest possible reasonable rate consistent with the maintenance of adequate service and the public interest." [16]

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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[15] 417 U.S. at 298.

[16] 390 U.S. at 792-93; *accord*, Atlantic Refining Co. v. Public Service Comm'n of New York (CATCO), 360 U.S. 378, 388 (1959).

APPENDIX F

SECTIONS 553, 556, 557, and 706 OF THE ADMINISTRATIVE PROCEDURE ACT, 5 U.S.C. §§ 553, 556, 557, and 706

5 U.S.C. § 553. Rule making

(a) This section applies, according to the provisions thereof, except to the extent that there is involved—

(1) a military or foreign affairs function of the United States; or

(2) a matter relating to agency management or personnel or to public property, loans, grants, benefits, or contracts.

(b) General notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include—

(1) a statement of the time, place, and nature of public rule making proceedings;

(2) reference to the legal authority under which the rule is proposed; and

(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

Except when notice or hearing is required by statute, this subsection does not apply—

(A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice; or

(B) when the agency for good cause finds (and incorporates the finding and a brief statement of

reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.

(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. When rules are required by statute to be made on the record after opportunity for an agency hearing, sections 556 and 557 of this title apply instead of this subsection.

(d) The required publication or service of a substantive rule shall be made not less than 30 days before its effective date, except—

(1) a substantive rule which grants or recognizes an exemption or relieves a restriction;

(2) interpretative rules and statements of policy; or

(3) as otherwise provided by the agency for good cause found and published with the rule.

(e) Each agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule. Pub.L. 89-554, Sept. 6, 1966, 80 Stat. 383.

5 U.S.C. § 556. Hearings; presiding employees; powers and duties; burden of proof; evidence; record as basis of decision

(a) This section applies, according to the provisions thereof, to hearings required by section 553 or 554 of this title to be conducted in accordance with this section.

(b) There shall preside at the taking of evidence—

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(1) the agency;

(2) one or more members of the body which comprises the agency; or

(3) one or more hearing examiners appointed under section 3105 of this title.

This subchapter does not supersede the conduct of specified classes of proceedings, in whole or in part, by or before boards or other employees specially provided for by or designated under statute. The functions of presiding employees and of employees participating in decisions in accordance with section 557 of this title shall be conducted in an impartial manner. A presiding or participating employee may at any time disqualify himself. On the filing in good faith of a timely and sufficient affidavit of personal bias or other disqualification of a presiding or participating employee, the agency shall determine the matter as a part of the record and decision in the case.

(c) Subject to published rules of the agency and within its powers, employees presiding at hearings may—

(1) administer oaths and affirmations;

(2) issue subpoenas authorized by law;

(3) rule on offers of proof and receive relevant evidence;

(4) take depositions or have depositions taken when the ends of justice would be served;

(5) regulate the course of the hearing;

(6) hold conferences for the settlement or simplification of the issues by consent of the parties;

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(7) dispose of procedural requests or similar matters;

(8) make or recommend decisions in accordance with section 557 of this title; and

(9) take other action authorized by agency rule consistent with this subchapter.

(d) Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof. Any oral or documentary evidence may be received, but the agency as a matter of policy shall provide for the exclusion of irrelevant, immaterial, or unduly repetitious evidence. A sanction may not be imposed or rule or order issued except on consideration of the whole record or those parts thereof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence. A party is entitled to present his case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct such cross-examination as may be required for a full and true disclosure of the facts. In rule making or determining claims for money or benefits or applications for initial licenses an agency may, when a party will not be prejudiced thereby, adopt procedures for the submission of all or part of the evidence in written form.

(e) The transcript of testimony and exhibits, together with all papers and requests filed in the proceeding, constitutes the exclusive record for decision in accordance with section 557 of this title and, on payment of lawfully prescribed costs, shall be made available to the parties. When an agency decision rests on official notice of a material fact not appearing in the evidence in the record, a party is entitled, on timely request, to an opportunity to show the contrary. Pub.L. 89-554, Sept. 6, 1966, 80 Stat. 386.

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5 U.S.C. § 557. Initial decisions, conclusiveness; review by agency; submission by parties; contents of decisions; record

(a) This section applies, according to the provisions thereof, when a hearing is required to be conducted in accordance with section 556 of this title.

(b) When the agency did not preside at the reception of the evidence, the presiding employee or, in cases not subject to section 554(d) of this title, an employee qualified to preside at hearings pursuant to section 556 of this title, shall initially decide the case unless the agency requires, either in specific cases or by general rule, the entire record to be certified to it for decision. When the presiding employee makes an initial decision, that decision then becomes the decision of the agency without further proceedings unless there is an appeal to, or review on motion of, the agency within time provided by rule. On appeal from or review of the initial decision, the agency has all the powers which it would have in making the initial decision except as it may limit the issues on notice or by rule. When the agency makes the decision without having presided at the reception of the evidence, the presiding employee or an employee qualified to preside at hearings pursuant to section 556 of this title shall first recommend a decision, except that in rule making or determining applications for initial licenses—

(1) instead thereof the agency may issue a tentative decision or one of its responsible employees may recommend a decision; or

(2) this procedure may be omitted in a case in which the agency finds on the record that due and timely execution of its functions imperatively and unavoidably so requires.

(c) Before a recommended, initial, or tentative decision, or a decision on agency review of the decision of

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subordinate employees, the parties are entitled to a reasonable opportunity to submit for the consideration of the employees participating in the decisions—

(1) proposed findings and conclusions; or

(2) exceptions to the decisions or recommended decisions of subordinate employees or to tentative agency decisions; and

(3) supporting reasons for the exceptions or proposed findings or conclusions.

The record shall show the ruling on each finding, conclusion, or exception presented. All decisions, including initial, recommended, and tentative decisions, are a part of the record and shall include a statement of—

(A) findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record; and

(B) the appropriate rule, order, sanction, relief, or denial thereof.

Pub.L. 89-554, Sept. 6, 1966, 80 Stat. 387.

5 U.S.C. § 706. Scope of review

To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall—

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be—

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

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(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;

(D) without observance of procedure required by law;

(E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or

(F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.

In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error. Pub.L. 89-554, Sept. 6, 1966, 80 Stat. 393.

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APPENDIX G

Sec. 1.20. Hearings.—. . .

(g) *Presentation by the parties.* (1) Parties and staff counsel shall have the right of presentation of evidence, cross-examination, objection, motion, argument and appeal. The taking of evidence and subsequent proceedings shall proceed with all reasonable diligence and with the least practicable delay.

Supreme Court, U. S.
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MICHAEL RODAK, JR., CLERK

Nos. 75-1289, 75-1299, 75-1304, 75-1308, 75-1368

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

THE CALIFORNIA COMPANY, A DIVISION OF CHEVRON OIL COMPANY, *et al.*,
Petitioners,

v.

FEDERAL POWER COMMISSION, *et al.*,
Respondents.

On Petitions for Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF RESPONDENT MOBIL OIL CORPORATION IN OPPOSITION TO PETITIONS

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

Nos. 75-1289, 75-1299, 75-1304,
75-1305, and 75-1308

THE CALIFORNIA COMPANY, A DIVISION
OF CHEVRON OIL COMPANY, *et al.*,
Petitioners,

v.

FEDERAL POWER COMMISSION, *et al.*,
Respondents.

On Petitions for Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

BRIEF OF RESPONDENT MOBIL OIL CORPORATION IN OPPOSITION TO PETITIONS

Mobil Oil Corporation, an intervenor in support of the respondent Federal Power Commission below and a respondent here, submits this brief in opposition to petitions for writs of certiorari to review the judgment entered in this case on October 14, 1975 by the United States Court of Appeals for the Fifth Circuit.

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OPINIONS BELOW

The opinion of the Court of Appeals is reported at 520 F.2d 1061 (Calco App. A),[1] and the Court of Appeals opinion denying rehearing is reported at 525 F.2d 1261 (Calco App. B). Federal Power Commission Opinion No. 699 is reported at 51 F.P.C. 2212 (Calco App. C); Federal Power Commission Opinion No. 699-H is not yet reported (Calco App. D).

JURISDICTION

Petitioners properly invoke the jurisdiction of this Court under 28 U.S.C. § 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b).

QUESTIONS PRESENTED

Mobil opposes all petitions seeking review of the judgment of the Court of Appeals, supports the position of the respondent Federal Power Commission, and limits this brief to the following questions:[2]

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[1] References are to the separate Appendix to the Petition of The California Company (Calco) filed in No. 75-1289.

[2] In No. 75-1299, Shell Oil Company, *et al.*, seek review of other questions concerning Commission choices of methodology and findings as to costs which the Court of Appeals held to be within the Commission's authority and discretion and supported by substantial evidence (Shell Pet., pp. 3-4, questions 1 and 3).

In No. 75-1304, American Public Gas Association similarly seeks review of Commission choices of methodology, use of data, and decisions as to costs, which were upheld below on similar grounds (APGA Pet., pp. 2-3, question 2).

In No. 75-1304, American Public Gas Association also seeks review of questions of procedure not actually presented in this case (APGA Pet., p. 2, question 1). In this instance, the Commission proceeded on the basis of successive public notices, sworn comments, data and pleadings, reply comments and pleadings, a public conference on specific issues, applications for rehearing, and oral argument (see Calco App. C-3 - C-18, App. D-4 - D-14). These procedures

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1. Whether the Federal Power Commission properly determined that rates prescribed as "just and reasonable" under Sections 4 and 5 of the Natural Gas Act for "new gas," as defined by the Commission, should be applied to natural gas sold by a producer under a new gas sales contract negotiated by the producer and a pipeline purchaser to replace an earlier long-term contract which has expired by its own terms.

2. Whether the Federal Power Commission reasonably found and concluded that (1) natural gas sold at rates established for "new gas" could not be applied to reduce individual producers' refund liabilities and to earn contingent rate escalations as prescribed and permitted by the Commission's earlier area rate decisions; and (b) individual producers should be afforded the option of selling at the new rates or of continuing to sell at area rates and to earn refund credits and rate escalations permitted by the area rate decisions.

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more than met the "minimal requirements" for "rulemaking" to prescribe rates under the Administrative Procedure Act, 5 U.S.C. § 553 and § 556(d), and the "hearing" requirements of Sections 4 and 5 of the Natural Gas Act where there is no genuine issue of disputed material facts (see Calco App. A-23 - A-22). The decision below thus presents no conflict with constructions of the APA and the Natural Gas Act by the Court of Appeals for the District of Columbia Circuit in *Mobil Oil Corporation* v. *FPC*, 483 F.2d 1238 (1973), and is consistent with other decisions of that court holding that where there is no such genuine issue of material fact, neither the APA nor the Natural Gas Act requires formal "adjudicatory" hearings. See *Pennsylvania Gas and Water Co.* v. *FPC*, 463 F.2d 1242, 1245 (D.C. Cir. 1972); *City of Chicago* v. *FPC*, 458 F.2d 731 (D.C. Cir. 1971), *cert. den.*, 405 U.S. 1074 (1972); *Municipal Light Boards of Reading and Wakefield, Mass.* v. *FPC*, 450 F.2d 1341, 1345 (D.C. Cir. 1971); *American Public Gas Association* v. *FPC*, 498 F.2d 718 (D.C. Cir. 1974). Procedures used by the Commission thus represent a permissible middle-ground between "minimal requirements" for "informal rulemaking" under the APA and adjudicatory-type hearings.

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STATUTES INVOLVED

Sections 4, 5, and 7 of the Natural Gas Act, 15 U.S.C. §§ 717c, d, and f, are involved and are set forth in Appendix E to the Petition in No. 75-1289.

STATEMENT

Mobil is an independent producer of natural gas and makes substantial sales in most of the production areas of the United States subject to Commission jurisdiction under the Natural Gas Act. Mobil participated in all proceedings before the Commission in this case and supported the Commission below in seeking affirmance of Commission Opinion Nos. 699 and 699-H. Procedural history pertinent to questions presented is:

1. On December 12, 1972, in its Opinion No. 639, the Commission announced its intention to phase out the so-called "two-tier" pricing or "vintaging" system initiated on an experimental basis in 1960, and to allow natural gas producers to receive the higher "new gas" rate where (1) a gas sales contract expires by its own terms, (2) the producer and the pipeline purchaser negotiate a new long-term contract permitting the higher rate, and (3) the new contract is filed with the Commission as part of an effective rate schedule under Section 4 of the Act. *Area Rates for Appalachian and Illinois Basin Areas*, 48 F.P.C. 1299, reh. denied, 49 FPC 361 (1973).[3]

By notice issued on April 11, 1973 in Docket No. R-389-B, the Commission initiated this case to determine a new uniform national rate for sales of natural gas produced from wells commenced on or after January

[3] This decision was affirmed in *Shell Oil Company* v. *FPC*, 491 F.2d 82 (5th Cir. 1974). Application of the decision to specific contracts and producer rate filings was affirmed in *Public Service Commission for the State of New York* v. *FPC*, —— F.2d —— (D.C. Cir. Nos. 73-1647, *et al.*, decided January 27, 1976).

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1, 1973 (R. 79, 80). In comments filed on May 16, 1973 and during 1974, respondents urged the Commission to apply the policy announced in Opinion No. 639 and permit application of the new rate to new contracts executed on or after January 1, 1973 to replace expired and expiring contracts. Reasons advanced were that such action would be consistent with Commission intent expressed in Opinion No. 639; the new price would encourage recompletions, reworking operations, and installation and maintenance of compression facilities; and the new price would prevent premature abandonment of existing reservoirs (R. 893).

In Opinion No. 699, issued June 21, 1974, the Commission considered the question and concluded that the new rate should apply to ". . . sales made pursuant to contracts executed on or after January 1, 1973, where the sales were formerly made pursuant to permanent certificates of unlimited duration under contracts which expired by their own terms on and after January 1, 1973, in accordance with Opinion No. 639 . . . ." (Calco App. C-2, C-107). The Commission supported this conclusion by reference to the need for additional revenues for expanded exploration and development programs, to offset of claimed attrition in the rate of return reflected in discounted cash flow studies, and to its purposes of encouraging new dedications to the interstate market "whether such new supplies come from new acreage dedications, or from newly drilled wells, or by diversion from other uses" (Calco App. C-108).

Various parties sought rehearing; oral argument followed; and on December 4, 1974, the Commission issued its Opinion No. 699-H, adhering to its decision on this question (Calco App. D-1, D-43 - D-47). In that opinion, the Commission found that claims for a higher rate of return were offset, in part, by the additional revenues to be available under renewal contracts qualifying for the

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national rate (Calco App. D-34); adhered to its views that eligibility was limited to contracts replacing a contract expiring by its own terms and to situations in which the producer and pipeline purchaser executed a new contract; and stated:

> "In many cases, the purchasing pipeline may desire a *quid pro quo* from the selling producer in the form of additional acreage dedication, exploration and development activity on the previously dedicated acreage, or other similar activities that could result in the dedication of additional new gas supplies to the interstate market. Such concessions by the seller certainly will not be made if the price is allowed to increase to the national rate automatically without the requirement of a renewal contract." (Calco App. D-45 - D-46)

In addition, the Commission found that much of the capital required for exploration, development, and production must come from "gas production revenues" (Calco App. D-55), and that the principles adopted would provide additional revenues, as contracts were renewed, and additional capital for exploration and development of "new natural gas supplies for the interstate market" (Calco App. D-55). The Commission also included estimates of such additional revenues in its assessment of impact of its decision upon the industry and consumers (Calco App. D-57).

Commission Opinion No. 699-H thus provides that the new rate applies to sales under new contracts executed on or after January 1, 1973 replacing contracts covering sales made under permanent certificates of unlimited duration which expired by their own terms either prior to or after January 1, 1973 (Calco App. D-78).

On review, the Commission's findings and conclusions were challenged, but the Court of Appeals affirmed (Calco App. A-1, A-27). First, the court found that

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there was adequate notice and a fair opportunity to be heard on the "renewal contract issue" before the Commission (Calco App. A-27). Second, the court found that the Commission had applied the new rate "functionally" with the objective of helping to "alleviate the current severe shortage"; that by requiring the prerequisite of a new contract, the Commission believed the purchaser "might be able to negotiate for additional acreage dedication to interstate commerce, or exploration and development activity on previously dedicated acreage or other concessions for the price increase"; and that the conflicting challenges buttressed the court's "deferral to the reasoned expertise of the Commission" (Calco App. A-29). The court held:

> "The FPC has reached a well-considered, expert decision on this issue. The Commission found from evidence in the record that a massive commitment of new funds is necessary to alleviate the natural gas shortage and that internally generated sums are a necessary source of such funds. Additionally, it noted that by phasing out the vintaging practice and attending price variations, all consumers would more equitably bear the burden of financing added exploration." (Calco App. A-30)

The court further noted that the question would be examined in biennial review of the new national rates, and the Commission had struck "a tentative balance between the consumer and investor interests," which it was prepared to reevaluate, and concluded:

> "Under such a circumstance, no party has carried the heavy burden of showing that the Commission's balance is tilted so far in either direction as to be unjust and unreasonable in its consequence. We also consider the decision, although not compelled by the evidence, to be supported by the substantial evidence of a shortage and the need for a massive infusion of funds." (Calco App. A-30)

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> "The Commission is not bound by its previous policies. As this Court and the Supreme Court have noted on various occasions, the rate structures which introduced or adjusted vintaging were experimental. It is necessary without a doubt that agencies be permitted latitude to evaluate old experiments and modify or abandon them when their best judgment requires such a course of action." (Calco App. A-31)

2. The Commission provided that the new national rate could not apply to sales of natural gas used to earn credits against individual producers' refund liabilities and escalations of rates permitted by its earlier area rate decisions.

In four area rate decisions, the Commission adopted a "package" rate structure, combining two tiers of rate levels, formulae for discharge of individual producer refund liabilities by dedication of new reserves to interstate purchasers, escalation of rates also tied to levels of new dedications, and moratoria on other rate increases for prescribed future years.[4]

In Opinion No. 699, the Commission determined that producers who elect to discharge their refund obligations by dedicating new supplies under these formulae, or to seek the contingent escalations by such dedications, must continue to price such natural gas at the area rates (Calco App. C-1, C-109 - C-110). The Commission concluded that such treatment was "equitable" and that:

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[4] See *Placid Oil Company* v. *FPC*, 483 F.2d 880 (5th Cir. 1973), aff'd, *Mobil Oil Corporation* v. *FPC*, 417 U.S. 283 (1974); *Texas Gulf Coast Area Rate Case*, 45 FPC 674, ultimately aff'd on remand, *Public Service Commission for the State of New York* v. *FPC*, 516 F.2d 746 (D.C. Cir. 1975); *Other Southwest Area Rate Case*, 47 FPC 99, *aff'd*, *Shell Oil Company* v. *FPC*, 484 F.2d 469 (5th Cir. 1973), *cert. den.*, *Mobil Oil Corp.* v. *FPC*, 417 U.S. 973 (1974); *Permian Basin Area Rate Case II*, 50 FPC 390 (appeal withdrawn).

> "To allow producers to collect the rate provided by this decision and to discharge their existing obligations and receive the benefits provided under the applicable area rate opinions with the same supplies of natural gas would be contrary to the spirit of the applicable area rate opinions. In essence, we seek to insure that a producer will not receive a double benefit from the rate structure which we establish in this decision." (Calco App. C-110, footnote omitted)

The Commission provided that individual producers must decide whether it is more beneficial to continue under the area rate formulae as to new sales or to obtain the national rate for such sales, and must file waivers as to the escalations and refund credits for sales the producer places under the national rate (Calco App. C-111).[5]

Producers who were beneficiaries of the refund-forgiveness formulae sought rehearing, but the Commission adhered to its conclusions in Opinion No. 699-H (Calco App. D-1, D-63). The Commission pointed out that the refund-forgiveness formulae were components of a total rate design in the area rate decisions, and that it was not reasonable to allow both those benefits and the new national rate for new sales (Calco App. D-64, D-65). In the Commission's view, allowance of both the new rate and the refund credits and contingent escalations allowed by the area rate decisions "would constitute an apostasy" of those opinions (Calco App. D-65).

The Court of Appeals affirmed the Commission, holding:

> "The new national rate is the product of an independent determination of incentives, and, as it is in

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[5] For sales placed under the national rate under such an election, the Commission provided for lifting of moratoria on rate increases imposed by the earlier area rate decisions (Calco App. C-115).

so many other regards, the new rate is not tied to previous determinations. Replacing one incentive structure with another or, viewed in another light, providing a new alternative rate system, is an exercise of Commission discretion which does not amount to retroactive rate regulation. See *Moss* v. *FPC*, 164 U.S. App. D.C. 1, 502 F.2d 461 (1974)." (Calco App. A-42)

ARGUMENT

None of the petitions presents questions requiring or warranting review by this Court:

I. The Court of Appeals Correctly Applied Standards And Principles of Review Required by the Natural Gas Act and Decisions of This Court

Petitioners assert that the judgment below is the result of erroneous application of standards of review under Section 19(b) of the Natural Gas Act and principles expressed by this Court. The assertions are incorrect.

In *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), this Court held that a "presumption of validity" attaches to exercise of the Commission's expertise, and that the functions of the Courts of Appeals under Section 19(b) were determinations of whether (1) the Commission had abused or exceeded its authority; (2) each of the essential elements of the Commission's rate order is supported by substantial evidence; and (3) the order may be expected "to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests, both existing and foreseeable" (390 U.S. at 791-792). The court's responsibility is not to "supplant" the Commission's balance of interests, but "to assure itself that the Commission has given reasoned consideration to each of the pertinent factors" (*Ibid*).

Thereafter, in *Mobil Oil Corporation* v. *FPC*, 417 U.S. 283 (1974), this Court held that application of these criteria is "primarily the task of the court of appeals"; responsibility "to assess the record to determine whether agency findings are supported by substantial evidence" is vested in the Court of Appeals by Section 19(b); and this Court will intervene "only in what ought to be the rare instance when the standard appears to have been grossly misapprehended or grossly misapplied" (417 U.S. at 309-310).

No such "rare instance" is presented. Controlling standards have been correctly apprehended and properly applied by the Court of Appeals. At the outset, the court noted, in express detail, "the *Permian* prescription" (Calco App. A-14 - A-19). The court then applied the criteria to each of the particulars of the Commission's order challenged below. Use of the "national rate" method was found within Commission authority (Calco App. A-20 - A-23); no error was found as to Commission procedures (Calco App. A-23 - A-27); specific cost findings, details of the rate structure, and Commission methods were found to be reasonable and supported by the record and substantial evidence (Calco App. A-27 - A-44); and the "end result" was sustained (Calco App. A-45).

It is correct that the Court of Appeals applied what was termed "kid-glove" treatment on some issues (Calco App. A-19). However, such deference was suggested in *Permian* (390 U.S. at 767, 791-792, 815); and in *Mobil*, this Court quoted with approval the earlier expression by the Fifth Circuit:

> " 'No one can honestly say that judges have been any more sure than commissioners, as all struggle with a problem that grows out of the peculiar mixture of a simultaneous service and exhaustion of a depletable asset. All have been groping. The day for groping is not yet over. And it does not denigrate what FPC

> has done to say that much may yet be imperfect and much remains to be done or redone. So we can find that FPC has conscientiously attempted to establish 'just and reasonable' rates within the framework allowed by judicial precedent, yet, it is still experimenting' " (*Mobil, supra*, 417 U.S. at 331).

No party, including Mobil, could assert that perfection, however perceived, has been reached in this case. The Commission frankly states that elements of a national rate structure will be reexamined in its biennial review of such rates (Calco App. C-112 - C-114; D-52 - D-56, D-63). The Court of Appeals similarly recognized that its review ". . . must be tailored to the practical requirements of the circumstances," and the burdens of procedural and evidentiary requirements must not be such that they ". . . would either prolong or complicate the task of the Commission to the point of impossibility." (Calco App. A-23).

Principles stated in *Permian* and *Mobil* thus were apprehended properly; standards of Section 19(b) of the Act were applied properly; and the decision of the Court of Appeals raises no questions requiring intervention of this Court.

II. The Court of Appeals Committed No Error In Affirming The Commission Decision To Allow The New National Rate For Sales Under New Contracts Replacing Expired Contracts

Petitioners in Nos. 75-1304, 75-1305, and 75-1308 seek review of the affirmance of the Commission's decision to allow the new national rate for sales under new contracts filed to replace long-term contracts which have expired or expire by their own terms (APGA Pet., p. 3; NYPSC Pet., p. 3; AGD Pet., p. 2). None of the petitions reflects reasons for review by this Court:

1. Petitioners' criticisms are (1) disagreement with the Court of Appeals' holding that the Commission's

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decision is supported by the record and substantial evidence (APGA Pet., pp. 11, 15-16; NYPSC Pet., pp. 15-22; AGD Pet., pp. 8, 10-11); (2) assertions that the Commission decision is lacking in rational consideration (APGA Pet., pp. 14, 16); NYPSC Pet., pp. 18-19; AGD Pet., pp. 6, 8, 11, 13); or (3) arguments that the Commission should have solved the problem addressed with alternatives more acceptable to these particular petitioners (APGA Pet., pp. 15-16; NYPSC Pet., pp. 22-23; AGD Pet., pp. 9-11).

However, each of these arguments was considered fully by the court below; criteria stated in *Permian* and *Mobil* were applied; and the Court of Appeals correctly concluded:

> "The FPC has reached a well-considered, expert decision on this issue. The Commission found from evidence in the record that a massive commitment of new funds is necessary to alleviate the natural gas shortage and that internally generated sums are a necessary source of such funds." (Calco App. A-29).
>
> * * * *
>
> "Under such a circumstance, no party has carried the heavy burden of showing that the Commission's balance is tilted so far in either direction as to be unjust and unreasonable in its consequence." (Calco App. A-30).

2. The Commission decision corrected an anomalous situation existent under the two-tier pricing system initiated in 1960 and is rationally supported.

Under the area-rate system, two separate ceiling rates were prescribed for "flowing" gas and "new" gas, depending upon date of contract. When a long-term contract covering "flowing" gas expired, the producer had the options of (1) seeking "abandonment" of the sale under Section 7(b) of the Act and a new contract with an interstate or intrastate buyer; or (2) continuing the sale,

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filing a unilateral rate increase to the level selected by the producer, and collecting such increased rate subject to refund pending hearings and decisions on reasonableness. See *United Gas Pipe Line Co.* v. *FPC*, 385 U.S. 83 (1966); *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137 (1960).

In 1972, the Commission reviewed this situation, the original Commission intent to phase out the "two-price" "vintaging" system, and the need to encourage prompt negotiation of replacement contracts. In its Opinion No. 639, the Commission thus concluded that when the producer and pipeline negotiated a new contract to replace a contract expiring by its own terms, deliveries under the new contract would be eligible for the "new" gas ceiling rate. *Area Rate for Appalachian and Illinois Basin Areas*, 48 FPC 1299, *reh. den.* 49 FPC 361 (1973), aff'd *sub nom Shell Oil Company*, 491 F.2d 82 (5th Cir. 1974).

In this case, the Commission reexamined this policy (Calco App. C-107). The Commission concluded *inter alia*, that sales under "replacement" contracts should be eligible for the new national rate to provide additional revenues for expanded exploration and development and additional dedications to the interstate market (Calco App. C-108 - C-109); a new contract negotiated by and acceptable to the purchaser was a necessary prerequisite to such eligibility (Calco App. D-43, D-45); the Commission thereby sought to assure additional commitments by the producer "in the form of additional acreage dedication, exploration and development activity on the previously dedicated acreage, or other similar activities that could result in the dedication of additional new gas supplies to the interstate market" (Calco App. D-45); and where such new contracts were negotiated, the additional revenues would provide "capital available to those entities which will explore for and develop new natural gas supplies for the interstate market" (Calco App. D-5).

The Court of Appeals' opinion reflects that these conclusions were not reached, as petitioners assert, in isolation and without reference to the extensive record. Thus, the record reflects that all parties had adequate notice and opportunity to be heard on the issue (Calco App. A-27); certain of the cost data before the Commission included then current costs of recompletions, deeper drilling, and "rejuvenating old wells to extend their productive life" (Calco App. A-10), and capital costs of recompletions (Calco App. A-11); the Commission was applying the rate "functionally" (Calco App. A-29); and the Commission had exercised its "discretion after considering all pertinent options" (Calco App. A-30).[6]

Contentions that the court below failed to canvass the record and apply proper standards of review thus are without foundation. The Commission's conclusions were supported and rationally considered, as the court held. Petitioners, in essence, simply seek to substitute their judgment for the reasoned conclusions of the Commission on questions of rate design and policy—questions which Congress entrusted to the Commission, as recognized in *Permian* and in *Mobil*.[7]

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[6] Commission use of a "functional" approach in rate design, to encourage exploration and development, was sanctioned in *Permian* (390 U.S. at 796-798) and again in *Mobil* over objections by New York strikingly similar to those now asserted here (417 U.S. at 319-321). The language of this Court in *Mobil* was similar to that of the court below in its reference to Commission rate design: "From these facts it reasoned that the national rate structure should be functionally applied to provide some of these funds, placing the burden not just on 'new' gas but also on flowing gas for which the primary contract had expired" (Calco App. A-30).

[7] A consistent fallacy in petitioners' arguments on the merits is their basic thesis that "costs" associated with "flowing gas" do not change, or are immune from inflation and rising costs. Yet, even "area rates" prescribed in the 1960s were based on cost components that are not frozen and which increase over time and declining lives of fields and reservoirs. See tabulations of cost components in *Permian Basin Area Rate Proceedings*, 34 FPC 159, 220 (1965);

3. Petitioners contend that this component of the Commission's rate design will have a dire impact on consumers, ignored by the Commission (APGA Pet., p. 15; NYPSC Pet., pp. 13, 15, 23; AGD Pet., pp. 12-13); but, again, the decisions below refute the inflated figures and exhortations.

First, as the Court of Appeals recognized, the Commission intends to evaluate, in its biennial review of the national rate structure, whether pipelines are negotiating in good faith and whether additional funds generated are reflected in monies committed to exploration and development and volumes of new supplies (Calco App. A-30). Petitioners thus not only seek to second-guess the Commission, but also imply that the Commission cannot be trusted to do what it plainly says it will do, a proposition correctly rejected by the Court of Appeals.

Secondly, petitioners' inflated numbers run afoul of the Commission's conclusion that ". . . today's consumers should share the burden of finding replacement supplies for the supplies which are being exhausted by the consumers" (Calco App. A-30). Petitioners overlook the obvious facts that any impact of the Commission's decision over the next three to five years is dependent upon (1) how many expired contracts pipelines are willing to replace, and (2) subsequent rate orders of the Commission. Moreover, petitioners' numbers, even if valid, can be assessed only in terms of national annual sales volumes exceeding multiples of trillions of cubic feet and required annual reserve additions also exceeding multiples of trillions of cubic feet (Calco App. C-19 - C-28), annual curtailments in multiples of billions of cubic feet (Calco App. C-37 - C-40), and annual capital requirements that can

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Southern Louisiana Area Rate Proceedings, 40 FPC 530, 603 (1968); *Hugoton-Anadarko Area Rate Proceedings*, 44 FPC 761, 937 (1970).

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be expressed only in billions of dollars (Calco App. D-55).

Lastly, petitioners' implications that the Commission did not consider impact of the decision as to replacement contracts is not in accord with the record. The Commission did make a study of projected, potential impact of the overall national rate structure (Calco App. D-56). That study was based on assumptions that *included* supplies to be sold under renegotiated contracts (Calco App. D-57). For all gas eligible for the new rate, including such supplies, the Commission estimated increases in the average residential price ranging from 0.71 per cent to 1.46 per cent in the first year, and after five years, ranging between 4.03 per cent and 16.46 per cent, under a variety of alternative assumptions (Calco App. D-59). The Commission also assessed impact of curtailments on residential, commercial, and industrial consumers, and the higher costs of alternative fuels, concluding:

> "In evaluating the overall public interest, we must consider the benefits to the consumer of an incremental supply of gas to provide reliable gas service compared to the consumer detriment if natural gas supply is reduced. The increased consumer cost attributable to higher well-head gas prices is more than counter-balanced by the more probable assurance of continued service" (Calco App. D-60).

4. The decision of the Commission to allow the national rate for replacement contracts thus was reached after "reasoned consideration" of factors cited by petitioners. Affirmance by the Court of Appeals was in full accord with the record, decisions of this Court, and the functions of the Court of Appeals on questions of substantial evidence under Section 19(b) of the Act.

This question does not require or warrant review by this Court.

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III. The Decision As To Refund Credits and Contingent Escalations Under Area Rate Orders Does Not Conflict With Constructions of The Natural Gas Act By This Court

Petitioners in Nos. 75-1289 and 75-1299 contend that this case presents questions of improper "retroactive rate-making" by the Commission (Calco Pet., pp. 2-3, 5-8; Shell Pet., pp. 3, 11-15). No such questions are presented.

In four area rate decisions, the Commission adopted integrated rate structures. These structures combined rate levels, contingent escalations, formulae under which individual producers could dedicate new supplies to work off refund liabilities incurred by collection of excess amounts during the 1960s and early 1970s, and related moratoria on other rate increases.[8]

The Commission and the courts recognized that the refund-forgiveness schemes accorded preference to producers who had collected the highest rates in the past and discriminated against producers who had made refunds and collected lower rates. See *Mobil Oil Corporation* v. *FPC*, 417 U.S. 283, 321-325 (1974). Even though these benefits were "icing" on the "cake" for the beneficiaries, the Court of Appeals and this Court nevertheless concluded that the recognized inequities were not the "degree of discrimination" which would make the schemes unlawful under the standards of Section 4 of the Act (*Mobil*, 417 U.S. at 324-325).

The Commission opinions in this case left these structures intact. The Commission affords the beneficiaries who still owe refunds the option of continuing to earn credits under the refund-forgiveness formulae, or of electing to receive the new national rate for specific sales and waiving additional credits for such sales under the refund and contingent escalation formulae (Calco App.

[8] See cases cited in fn. 4, *supra* p. 8.

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C-1, C-109 - C-110, D-64 - D-65). The Commission concluded that such treatment was "equitable," consistent with the "spirit of the area rate" decisions, and prevented "a double benefit" for the beneficiaries of those decisions (Calco App. C-110). Thus, each producer must weigh the comparative benefits individually and then choose to continue to earn the refund credits and escalations, or choose to obtain the higher national rate and waive such credits and escalations (Calco App. D-64 - D-65).

On review, the producers who apparently still owe refunds contended that such treatment constituted "improper retroactive modification" of the area rate decisions (Calco App. A-42). The Court of Appeals disagreed, holding that there was no such modification; the national rate rested upon "an independent determination of incentives"; and replacing one structure, or "providing a new alternative rate system, is an exercise of Commission discretion which does not amount to retroactive rate regulation" (Calco App. A-142).

The holding is correct and not in conflict with this Court's construction of the Natural Gas Act. Certainly, retroactive change of final rate orders is not permitted under this statute,[9] but the Commission has not violated that prohibition. The individual producer decides which of the alternative rate structures is most profitable to that producer; the option of continuing to receive all of the benefits and "iced cake" of the area rate decisions remains available; and the option of receiving the national rate is provided.

What the Commission has done thus simply is to decline to spread even more icing upon the "iced cake." The refund formulae were affirmed as a valid exercise of

---

[9] See *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 618 (1944); *FPC* v. *Sunray DX Oil Co.*, 391 U.S. 9, 24 (1968); *Montana-Dakota Utilities Co.* v. *Public Service Co.*, 341 U.S. 246, 254 (1951).

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Commission discretion in design of a rate structure (*Mobil*, 417 U.S. at 324-326), and so too is the Commission's decision to continue that structure as an available option for those producers who still owe refunds for excess collections in the 1960s and early 1970s.[10]

Questions as to "retroactive ratemaking" therefore are not raised in this case, and there is no conflict with this Court's decisions.

CONCLUSION

For the foregoing reasons, the petitions should be denied.

Respectfully submitted,

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April 9, 1976

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[10] To paraphrase this Court's observations in *Mobil*, certain producers voluntarily charged the higher rates in the 1960s and 1970s; voluntarily exercised a "business judgment" in declining to settle, reduce rates, and make refunds in those past years; and voluntarily entered into a later settlement, now embodied in the area rate decisions, to work off those refund liabilities. Now, the Commission permits further voluntary exercise of the same "business judgment": if the refund credit formulae still are more profitable, a producer can continue to receive the credits and benefits, but if the "business judgment" is that the national rate is more beneficial, the producer may elect to charge that rate and cease earning the credits (*cf. Mobil*, 417 U.S. at 324-325, 327).

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NOS. 75-1289, ET AL.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

NO. 75-1304

AMERICAN PUBLIC GAS ASSOCIATION, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

NO. 75-1305

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

NO. 75-1308

ASSOCIATED GAS DISTRIBUTORS, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

BRIEF OF RESPONDENT PRODUCERS IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI

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NOS. 75-1289, ET AL.

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AMERICAN PUBLIC GAS ASSOCIATION, *Petitioner,*

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NO. 75-1305

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, *Petitioner,*

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FEDERAL POWER COMMISSION, *Respondent.*

NO. 75-1308

ASSOCIATED GAS DISTRIBUTORS, *Petitioner,*

v.

FEDERAL POWER COMMISSION, *Respondent.*

BRIEF OF RESPONDENT PRODUCERS IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI

Shell Oil Company, *et al.*[1], herein called "Producers", parties to the case below and Respondents in Case Nos. 75-1304, 75-1305, and 75-1308[2], hereby submitted their

1. A complete list of the Producer Respondents joining herein is contained on the inside cover of this Brief.

2. Some of the parties joining herein are also Petitioners in Case No. 75-1299. Parties hereto take no position as to whether the Petition in Case No. 75-1289 should be granted.

Brief in Opposition to the Petitions filed in Case Nos. 75-1304, 75-1305, and 75-1308, for Writs of Certiorari to review the Opinion and Judgment of the United States Court of Appeals for the Fifth Circuit entered in this case on October 14, 1975.

STATEMENT OF POSITION

The principal question raised by Petitioners in Case Nos. 75-1304, 75-1305, and 75-1308, is whether the Commission is required by the Natural Gas Act or previous decisions of this Court to adhere to the "two-price" or "multiple vintage price" approach to producer pricing which it had adopted in the earlier area rate decisions[3], or whether it has discretion to find that this approach has failed to elicit adequate gas supplies, and should be gradually phased out.

The "phase-out" procedure, in which the Commission permits "old" gas to become "new" with reference to the ceiling price to be applied to the gas, when the initial long-term contract under which the gas was sold has expired by its terms[4], and the producer and pipeline purchaser have entered into a new contract "rededicating" the gas to the interstate market, was initially announced by the Commission in the *Appalachian Area Rate Decision*, 48 F.P.C. 1299 (1972). It was strongly attacked on appeal by the Public Service Commission of New York,

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3. *Permian Basin Area Rate Decision*, 34 F.P.C. 159, reversed, *Skelly Oil Co. v. F.P.C.*, 375 F.2d 6 (10th Cir. 1967), reversed and Commission affirmed, *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968); *Southern Louisiana Area Rate Case II*, 46 F.P.C. 86; affirmed, *Placid Oil Co. v. F.P.C.*, 483 F.2d 880 (5th Cir. 1973); affirmed, *Mobil Oil Corp. v. F.P.C.*, 417 U.S. 283 (1974).

4. Acceleration of the expiration date initially provided in the contract is not permitted under the Commission orders.

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Petitioner in Case No. 75-1305, and the Associated Gas Distributors, Petitioner in Case No. 75-1308. After hearing the same arguments raised here, the United States Court of Appeals for the Fifth Circuit affirmed the Commission in *Shell Oil Company v. F.P.C.*, 491 F.2d 82 (1974).

The Commission continued its new policy in its *Rocky Mountain Area Rate Decision*, 49 F.P.C. 924, 49 F.P.C. 1279 (1973), and in its second *Permian Basin Area Rate Decision*, 50 F.P.C. 390, 50 F.P.C. 932 (1973), appealed to the United States Court of Appeals for the Ninth Circuit, *Public Service Commission of the State of New York v. F.P.C.*, Case No. 73-3328, petition withdrawn. New York and AGD continued their challenge to the Commission's new policy, appealing various orders implementing this policy in other areas. These appeals were taken to the United States Court of Appeals for the District of Columbia Circuit, which also upheld the Commission in *Public Service Commission of New York v. F.P.C.*, ____ F.2d ____ (Case Nos. 75-1647, *et al.*, D.C. Circuit, issued January 27, 1976).

In the case below, the Commission had before it substantial evidence of the massive capital requirements of the producing industry, if that industry is to accomplish even the minimum objective of replacing natural gas supplies being currently produced. Even if the National Ceiling Rate For New Gas were high enough to constitute the necessary incentive for investment, which Producers dispute[5], it would be many years before enough gas

5. The reasons why the National Ceiling Rate is inadequate as an incentive are succinctly summarized in Commissioner Moody's dissent to Opinion No. 699, C.A. C-220-C-227.

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could be found and dedicated to substantially increase the industry's revenues, and provide needed capital.[6]

The principal source of *current* capital for gas exploration must be revenues from the sale of gas already found and in production. This method of satisfying this need for capital availability is relied upon by the Commission at various places in its opinion (C.A. D-34, 35; C.A. D-54, 55, C.A. D-75) in support of its adoption of a minimal rate of return (C.A. D-34, 35; C.A. D-75), and its refusal to give effect to other "non-cost" factors. This evidence was also relied on by the Court of Appeals in affirming the Commission on this issue (C.A. A-29).

In addition to the need for generation of capital to perform gas exploration, the Commission also had before it evidence that as a gas reservoir nears depletion, as is usually the case after the expiration of a long-term (usually 20 years) contract, additional expenditures for compression, well workovers, etc. are required to continue the gas on production. If the price is adequate, these expenditures will be made. If it is not, the wells will be abandoned and the remaining reserves lost. From the standpoint of the cost to the consumer, even allowing for an increase in the price paid the producer, this gas is less expensive than newly discovered gas supplies, be-

6. The impact of the phase-out procedure was estimated in the dissenting opinion of Commissioner Smith at 2.6 billion dollars, a figure cited in all three Petitions. This is a gross overstatement. As New York admits (p. 14), the impact has already been reduced by an increase in the ceiling price allowed all "flowing" gas in Docket No. R-478 by one-third. Commissioner Smith also failed to consider the fact that new contracts will not be immediately signed by the pipelines, delaying the application of the new ceiling. New wells drilled on renegotiated contracts would receive the new rate in any event further reducing the impact of this procedure. The overall impact of the entire rate structure was considered by the Commission (C.A. D-56 to D-62). This is all that is required.

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cause all of the pipeline facilities needed to connect the gas are already in place and must be included in the pipeline rate base, whether they are used or not.

New York (p. 17) and APGA (p. 15) insist that the premature abandonment problem be handled on an individual case-by-case basis through applications for "special relief" from the ceiling rates to the Commission, in which the producer would be required to prove that the gas could not be continued in production under the ceiling for "old" gas before a higher rate was allowed. Like the individual company cost-based rate approach condemned in *Permian*[7], an individual case-by-case approach to this problem is doomed to failure by the administrative burden and lengthy delays occasioned by the procedure.[8]

We therefore believe, as did the Court of Appeals (C.A. A-31), that the Commission had substantial evidence in the record, and sufficient discretion and authority under the Act and decisions of this Court and those of various Courts of Appeals, to modify and "phase out" the multiple vintage price system.

APGA raised two additional questions, one of which has already been resolved by the courts adversely to their position, and the other of which amounts to a choice of various alternative costing methods which is clearly within the Commission's discretion.[9] We will briefly discuss why

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7. *Permian Basin Area Rate Cases*, 390 U.S. 747, 757.

8. It is also noteworthy that in the few cases where this approach has been attempted, it has been reversed by the Courts, see *Macdonald v. F.P.C.*, 505 F.2d 335 (D.C. Cir. 1974); *Cities of Fulton, et al. v. F.P.C.*, 512 F.2d 947 (D.C. Cir. 1975).

9. The questions raised as to the amount of liquid credit and the credibility of the reserves estimate are clearly matters within the Commission's discretion and do not require review here.

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these questions also do not warrant this Court's consideration.

REASONS FOR DENYING THE PETITIONS FOR WRITS IN CASE NOS. 75-1304, 75-1305, AND 75-1308

I. The Questions Raised By These Petitions Do Not Fall Within The Standards Of Review Laid Down By This Court.

In *Mobil Oil Corp. v. F.P.C.*, 417 U.S. 283 (1974), this Court reiterated and amplified the standards of review of Federal Power Commission Orders laid down in *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), and *Permian Basin Area Rate Cases*, 390 U.S. 747, at 767 (1968). The Commission was given broad discretion to select modes of regulation, which would not be overturned by the courts unless they lacked support by substantial evidence, or unless the Commission had exceeded or abused its authority. Here the Commission has made a determination, repeated in three area rate decisions, innumerable specific orders, and the major national rate decision here under review, that the two-price system initially adopted as an experiment in *Permian* was theoretically unsound (C.A. D-54, 55) and has dramatically failed to produce adequate supplies of natural gas for the consumers of this nation (C.A. C-19 to C-29). The Commission therefore decided to gradually eliminate the multiple vintage price system by allowing gas in the latter stage of the depletion process (the time when additional expenditures may expand reserves by deferring the abandonment date) to be priced at the ceiling rate for "new" gas. Over a period of years the "vintaging" of gas

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prices will gradually disappear (Court of Appeals opinion, C.A. A-31), thus minimizing the impact on the consumer. This type of policy decision is discretionary with the Commission; thus, under *Mobil, supra* (417 U.S. 283, 308), the Court should not "supplant" the Commission's decision. *Mobil* further teaches that the review of the Commission's decision is the primary function of the Court of Appeals, and

> "'. . . This Court will intervene only in what ought to be the rare instance where the standard appears to be misapprehended or grossly misapplied.' Universal Camera Corp. v. NLRB, 340 U.S. 474, 491." (417 U.S. 283, 310)

The Court of Appeals thoroughly reviewed the Commission's action utilizing the *Mobil* standards (C.A. A-28 to A-31). No further action is required by this Court.

II. The Commission's Decision To Abolish Vintaging Is Soundly Based, Both In Theory And In Substantial Record Evidence.

A. The Two-Price System Has Failed.

The Commission's Opinion below points out at length the developing shortage of natural gas in the United States, and the manifest failure of the *Permian* method of regulation to cope with the growing shortage (C.A. C-19 to C-43). The basic reason for the failure, discussed in depth in the concurring and dissenting opinion of Commissioner Moody (C.A. C-169 to C-229), is that in a period of inflation and increasing costs, holding the bulk of the nation's gas supply to rates which are based upon the estimated *original* cost of developing these reserves

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will not provide the capital required to replace those reserves with new supplies. It is the view of the Producers that the Commission has failed to recognize that its cost-based rate is too low, both in the manner of its calculation, and as judged by external market tests. In so doing, it has created a ceiling rate which is much too low to provide even future incentives to resolve the gas shortage. This is tacitly admitted by Petitioners, who urge that the producers will not recommit the capital obtained by the abolition of the vintaging policy to further gas exploration unless the funds are earmarked, and their use policed, by the Commission (New York, p. 17; AGD, p. 9; APGA, p. 15). If the Commission's ceiling price is what it is statutorily required to be, and will provide a return sufficient to attract investment (*Permian*, 390 U.S. 747, 796), then such earmarking and policing are not required.

The Commission has treated the inclusion of a portion of the gas already flowing in the "new" gas vintage ceiling as a "non-cost" factor to provide additional capital to the industry which cannot be provided by the ceiling price for future gas, no matter what the level of that price may be. In addition, it has imposed the serious requirement that the purchasing pipeline company must sign a new contract before the new vintage price will apply. As The Superior Oil Company pointed out to the Court of Appeals, the pipeline is in a vastly superior bargaining position, as the gas must continue to be sold to it unless and until the Commission permits abandonment (see *Sunray Mid-Continent Oil Co. v. F.P.C.*, 364 U.S. 137 (1959). The producer must provide some new consideration to the pipeline before the pipeline will renegotiate the contract, where the only effect of the renegotiation is to permit the application of a higher ceiling price. Con-

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trary to the allegations of Petitioners, the pipelines *have* required further consideration, such as, commitment of additional new reserves, further exploration or development expenditures, before entering into "renegotiated" contracts.

In *Mobil, supra,* this Court specifically approved the new Commission policy of placing part of the burden of expanding gas exploration on all users of natural gas, rather than on those alone who purchase gas in the future (417 U.S. 283, 320). The current Commission decision represents a permissible expansion of this policy.

B. The Two-Price System Has Always Been Theoretically Unsound And Discriminatory.

Although this Court in *Permian* approved the use of the two-price system on an "experimental" basis, it did so as a proper use of the Commission's discretion, not on any mandatory basis, see *Permian,* 390 U.S. 747, 797-98.

The theory of the two-price system was sharply criticized by the Court of Appeals for the Fifth Circuit in *Placid Oil Co. v. F.P.C.,* 483 F.2d 880, 899-900 (1973). That Court discussed the logical inconsistency of arbitrarily distinguishing an indistinguishable commodity by date of contract (see 488 F.2d at 890). This Court approved the Fifth Circuit's reasoning in *Placid* in its *Mobil* decision, *supra,* specifically rejecting arguments made by New York, one of the Petitioners here (No. 75-1305) that the entire burden of the cost of finding new gas supplies must be placed on the consumers of those supplies, and not on existing users, see 417 U.S. at 320.

The Commission has already substantially departed from the *Permian* two-price system prior to this case. In

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Opinion No. 567, 42 F.P.C. 727 (1969), the Commission provided that new reservoirs discovered under "old" vintage contracts should receive the "new" vintage price where the date of discovery of the reservoir was "new" vintage. In another part of the Opinion below (C.A. C-154, C-155), the Commission included under the "new" gas ceiling price wells commenced on previously contracted acreage, where the well was commenced in the "new" vintage time period. This part of the Opinion is not challenged by Petitioners. Yet these are similar efforts by the Commission to phase out the "anachronistic" (*Appalachian Area Rate Decision*, 48 F.P.C. 1299, 1309, affirmed, *Shell Oil Co. v. F.P.C.*, 491 F.2d 32 (5th Cir. 1974)) multiple vintage price system.

III. The Other Questions Raised By The American Public Gas Association Do Not Merit Consideration By This Court.

A. The Commission's Power To Establish Rates By Rulemaking Has Been Affirmed By Three Circuit Courts of Appeals, Following *United States v. Florida East Coast Railway*.[10]

The American Public Gas Association's attack on the power of the Commission has been unanimously rejected in all of the courts where it has been raised, and the courts have held that the formal hearing processes of the Administrative Procedure Act are not required, see *Phillips Petroleum Co. v. F.P.C.*, 475 F.2d 842 (10th Cir. 1973), *cert. denied, sub nom. Chevron Oil Co. v. F.P.C.*, 414 U.S. 1146 (1974); *American Public Gas Association*

10. 410 U.S. 224 (1973).

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v. F.P.C., 498 F.2d 718 (D.C. Cir. 1974); *United States v. Florida East Coast Ry.*, 410 U.S. 224, 246 (1973).

Far from being contrary to the decision of the Court of Appeals below, as alleged by APGA (p. 8), the decision of the District of Columbia Circuit in *Mobil Oil Corp. v. F.P.C.*, 483 F.2d 1238 (1973) is completely consistent with the Commission's actions here and the decision below of the Fifth Circuit. The D. C. Circuit *declined* to hold that the Commission was required to follow the procedures set out in Sections 556 and 557 of the Administrative Procedure Act (see 483 F.2d at 1250, 1253-54). The D.C. Circuit required only that each party be given ample opportunity to criticize and attack contrary positions taken by other parties (see 483 F.2d at 1258). This the Commission did in the proceedings below (C.A. C-14 to C-18, D-6, 7).

The Court of Appeals below thoroughly considered APGA's arguments and found that all procedural requirements of the Natural Gas Act and Administrative Procedure Act had been satisfied (C.A. A-23 to A-27). No review is required by this Court.

B. The Commission Has Discretion To Adopt The DCF Costing Method On Rehearing.

APGA is the only Petitioner contending that the Commission's adoption of the discounted cash flow ("DCF") costing methodology is not within the Commission's discretion. APGA's argument is without merit for three reasons.

First, substantial record evidence warranted adoption of DCF costing methodology. Dr. Ezra Solomon presented

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extensive testimony demonstrating that this is the only methodology the Commission could use to accurately state anticipated rate of return on capital investment since this is the only methodology which takes into account receipts on investment relative to time of outlay, that is, the time value of money. Mr. Robert H. Park submitted testimony illustrating an actual DCF format.

Second, in approving the Commission's choice of the DCF methodology, the Court pointedly stated that:

> "Without delving into the complexities of an esoteric costing methodology which counsel could scarcely describe in their briefs or at oral argument, we need only note that a reviewing court would go far afield in striking down an analytical model adopted by the Commission." (C.A. A-36)

The selection between the various types of costing methodology lies within the Commission's discretion, see *Permian* (390 U.S. 747, 776-77).

Third, the Court of Appeals correctly ruled that Petitioners in the case below failed to demonstrate that use of DCF methodology produced an unjust and unreasonable end result.

No new arguments against use of DCF methodology have been raised in Petitions to this Court. The Court of Appeals correctly decided that no grounds exist for striking down the DCF methodology employed by the Commission in this proceeding.

CONCLUSION

None of the questions raised in Case Nos. 75-1304, 75-1305, and 75-1308 invoke review by this Court under the standards of *Mobil*. The gradual elimination of the

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"vintage" price system, an experiment which was theoretically wrong and has manifestly failed, is long overdue. These Petitions for Certiorari should be denied.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1975

NOS. 75-1289, 75-1299,
75-1304, 75-1305,
75-1308, and 75-1474

THE CALIFORNIA COMPANY, ET AL., PETITIONERS

v.

FEDERAL POWER COMMISSION

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL POWER COMMISSION IN OPPOSITION

QUESTIONS PRESENTED

1. Whether the rulemaking procedures followed by the Federal Power Commission in establishing a nationwide ceiling rate for new sales of natural gas satisfied the requirements of the Natural Gas Act and the Administrative Procedure Act.

2. Whether the court of appeals applied the correct standard of review in affirming the Federal Power Commission's orders.

3. Whether the Federal Power Commission properly determined that the national rate may be applied to ongoing sales of natural gas if the original contract

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expires of its own terms, a renewal contract is executed, and one of those events occurs on or after January 1, 1973.

4. Whether the Federal Power Commission correctly determined that natural gas sold at the national rate could not be used to discharge refund obligations or trigger contingent escalations under the incentive provisions of prior area rate orders.

5. Whether the cost methodology employed by the Federal Power Commission is reasonable and supported by substantial evidence.

STATEMENT

1. On April 11, 1973, the Federal Power Commission commenced by public notice a rulemaking proceeding to establish the maximum just and reasonable rates for jurisdictional sales of natural gas on a nationwide basis (38 Fed. Reg. 10014). The single uniform rate was to apply to all jurisdictional sales of natural gas produced from wells commenced on or after January 1, 1973. The notice made all large producers respondents to the ratemaking proceeding, provided for the submission of sworn written comments from all interested parties as well as the named respondents, and was accompanied by a staff study on the estimated nationwide cost of finding and producing new natural gas supplies. In the notice, the Commission did not propose any specific rate, terms, or conditions and stated that it would rely instead upon the information contained in the responses submitted by the various parties and the staff study.[1]

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[1]On March 21, 1974, the original notice of rulemaking was supplemented by the issuance of a revised notice in which staff cost estimates were updated to reflect 1972 data concerning drilling costs and reserve additions (39 Fed. Reg. 11310). The study indicated that the American Gas Association (AGA) reserve additions

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Following the receipt of extensive initial and reply comments and evidentiary presentations, the Commission, on June 21, 1974, issued Opinion No. 699 (Pet. App. C), establishing a new national rate structure for producer sales that was designed to alleviate the increasingly critical gas supply shortage while maintaining reasonable prices (*id.* at C120). The salient features of the rate structure were:

1. A base rate of 42.0¢ per Mcf (with annual escalations of 1.0¢ per Mcf) subject to various adjustments.

2. A biennial review to prescribe prospective just and reasonable rates for those sales that qualify for the national rate.

3. Provisions for special relief from the national rate.

The base rate would apply to three classes of sales:

1. Sales made from wells commenced on or after January 1, 1973.

2. Sales made pursuant to a contract executed on or after January 1, 1973, for the sale of gas in interstate commerce, if the gas has not previously been sold in interstate commerce except under short-term or emergency sales procedures of the Commission's regulations.

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for 1971 and 1972 might have been understated by approximately 1.7 trillion cubic feet. Since the AGA data had played an important role in the Commission's cost analysis, comments were invited concerning this apparent disparity. A public conference was held, and the AGA was unable to refute the staff's finding. The Commission's cost analysis therefore included the finding that "the reserve additions as reported by the AGA for 1971 and 1972 are understated by approximately 1.7 Tcf" (Pet. App. C55-C56).

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3. Sales made pursuant to a renewal contract, if the sales were formerly made pursuant to a permanent certificate of unlimited duration under a contract that expired by its own terms, and if either the renewal contract was executed or the original contract expired on or after January 1, 1973.[2]

As part of the total rate structure the Commission also determined that natural gas sold at the new national rate could not be used to discharge refund obligations or to trigger contingent escalations under the incentive provisions of its orders in four prior area rate proceedings (Pet. App. C109-C111). Rather, producers who elect to discharge their existing refund obligations or who desire to obtain the contingent escalations for flowing gas under these prior area rate orders will be required to price the flowing gas at the rate established in the area rate orders. The Commission found this treatment "equitable since the rates established in those opinions were determined to be sufficient to encourage exploration and development activities when coupled with the [incentives]" (*id.* at C110). It stated that "[t]o allow producers to collect the [national] rate * * * and to discharge their existing obligations * * * with the same supplies of natural gas would be contrary to the spirit of the applicable area rate opinion" and would allow

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[2]This statement of the third sales category, the so-called "renewal contract" provision, encompasses later amendments to the original order. As originally stated, the category was limited to renewal contracts executed on or after January 1, 1973, which replaced contracts expiring on or after that date. The provision was later amended to include renewal contracts executed on or after January 1, 1973, even if the primary contract expired prior to that date (Opinion No. 699-A). The provision was amended further to include renewal contracts executed prior to Janaury 1, 1973, to replace primary contracts expired or expiring on or after that date (Pet. App. D43-D45).

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producers to "receive a double benefit from the rate structure which we establish in this decision" (*ibid.*).

Subsequently, in Opinion No. 699-H, the Commission increased the rate ceiling for "new gas" sales from 43.0¢ to 50.0¢ per Mcf, following a supplemental cost analysis "to assure that the rate allowed for new gas supplies adequately reflects the true cost of those supplies" (Pet. App. D15).

2. On petitions for review, the court of appeals affirmed the Commission's orders (Pet. App. A). The court ruled that the Commission could properly establish a national rate for new sales of gas by rulemaking without "adversarial trial procedures such as formal evidentiary hearings, oral testimony, and oral cross-examination" (*id.* at A23). "The procedures used in setting the national rate neither prejudiced [the participants], nor prevented a full and true disclosure of the facts" (*id.* at A25). In "an undertaking so massive and novel as setting a national rate for new gas, the proceeding would have taken years, and the Commission's power to effectively regulate the industry would have been destroyed," if the Commission had "allowed all interested parties to submit oral testimony and conduct oral cross-examination" (*id.* at A26-27).

The court also rejected each of the other attacks on the order that are reiterated in the present petitions:

(a) The Commission's cost methodology was attacked from both sides, some parties claiming that it led to a national rate for new gas that was inadequate to generate capital for future exploration and others contending that the resulting rate was too high. The court of appeals, however, approved the Commission's cost-based methodology and concluded that the national rate

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was within the zone of reasonableness accorded by reviewing courts to Commission action (*id.* at A31-A41).[3]

(b) The court also sustained the application of the new national rate to certain renewal contracts replacing old contracts for flowing gas. The court held (*id.* at A28-A30) that the Commission could properly make the rate for flowing gas bear part of the cost burden of financing added exploration. "The Commission found from evidence in the record that a massive commitment of new funds is necessary to alleviate the natural gas shortage and that internally generated sums are a necessary source of such funds" (*id.* at A29). The court therefore upheld the Commission's determination "that the national rate structure should be functionally applied to provide some of these funds, placing the burden not just on 'new' gas but also on flowing gas for which the primary contract had expired" (*id.* at A30).

(c) Finally, the court of appeals sustained the Commission's determination that natural gas sold at the national rate could not be used to discharge refund obligations or to trigger contingent escalations (*id.* at A41-A42). The court held that this feature of the new national rate did not constitute "an improper retro-

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[3]The Commission's cost analysis was based upon the methodology developed in the first *Permian Basin Area Rate Proceeding*, 34 F.P.C. 159. The Commission found that the record evidence supported a range of reasonable costs, and it selected a rate within the range of rates supported by those costs that "will provide the incentive necessary to encourage producers to undertake expanded exploration and development programs and to dedicate the natural gas discovered and produced as a result of those programs to the interstate market" (Pet. App. C120). In a departure from the *Permian* methodology, the Commission also employed a discounted cash-flow model in evaluating its cost findings "to assure that the rate allowed for new gas supplies adequately reflects the true cost of those supplies" (Pet. App. D15).

active modification of prior rate opinions" (*id.* at A42). "The new national rate is the product of an independent determination of incentives, and, as it is in so many other regards, the new rate structure is not tied to previous determinations. Replacing one incentive structure with another or, viewed in another light, providing a new alternative rate system, is an exercise of Commission discretion which does not amount to retroactive rate regulation" (*ibid.*).

ARGUMENT

The contentions raised in the petitions were carefully reviewed and correctly rejected by the court of appeals; further review by this Court is not warranted.

1. Petitioner American Public Gas Association (APGA) (Pet. No. 75-1304, pp. 6-11) contends that the Commission's use of a rulemaking process to establish the national rate violated both the Natural Gas Act and the Administrative Procedure Act. APGA argues that the Commission erred in failing to follow in these rate proceedings the formal hearing procedures of 5 U.S.C. 556 and 557. But those procedures—requiring a full evidentiary hearing before a hearing officer, an initial decision, and review by the Commission—are required for rulemaking only "[w]hen rules are required by statute to be made on the record after opportunity for an agency hearing" (5 U.S.C. 553(c)). Therefore, "Sections 556 and 557 need be applied 'only where the agency statute, in addition to providing a hearing, prescribes explicitly that it be 'on the record'" *United States* v. *Allegheny-Ludlum Steel Corp.*, 406 U.S. 742, 757. This principle applies to agency ratemaking. *United States* v. *Florida East Coast Railway Co.*, 410 U.S. 224. Since neither the ratemaking provisions of the Natural

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Gas Act (15 U.S.C. 717c, 717d) nor the rulemaking provision (15 U.S.C. 717o) requires a hearing "on the record," the formal hearing procedures of the Administrative Procedure Act are not required in the Commission's ratemaking.

APGA contends, however, that the provision in 15 U.S.C. 717r(b), making the Commission's findings conclusive if supported by substantial evidence, is the equivalent of an "on the record" requirement (Pet. No. 75-1304, p. 7). Concededly the precise words "on the record" are "not words of art, and * * *other statutory language having the same meaning could trigger the provisions of §§556 and 557 in ratemaking proceedings" *(Florida East Coast Railway Co., supra,* 410 U.S. at 238). But the three courts of appeals that have addressed the issue, including the court of appeals in this case, have uniformly concluded that neither the express provisions of the Natural Gas Act nor their legislative history requires a formal evidentiary hearing in Federal Power Commission ratemaking proceedings. *Mobil Oil Corp.* v. *Federal Power Commission,* 483 F.2d 1238 (C.A. D.C.); *American Public Gas Association* v. *Federal Power Commission,* 498 F.2d 718 (C.A. D.C.); *Phillips Petroleum Co.* v. *Federal Power Commission,* 475 F.2d 842 (C.A. 10), certiorari denied *sub nom. Chevron Oil Co.* v. *Federal Power Commission,* 414 U.S. 1146.

In any event, the words "substantial evidence" as used in 15 U.S.C. 717r(b) add nothing to the "after a hearing" language of 15 U.S.C. 717d(a), which by itself is insufficient to trigger the formal hearing requirements. *Allegheny Ludlum Steel Corp., supra.* When viewed in light of 15 U.S.C. 717n(b), which states that "[n]o informality in any hearing, investigation, or proceeding or in the manner of taking testimony shall invalidate any order, decision, rule, or regulation," the language

of 15 U.S.C. 717r(b) does not amount to an "on the record" requirement that would invoke the formal procedures of 5 U.S.C. 556 and 557.[4]

Finally, the decision below does not conflict with the District of Columbia Circuit's decision in *Mobil Oil Corp.* v. *Federal Power Commission, supra.* In *Mobil* the court held that, although a formal evidentiary hearing is not required for ratemaking, the less rigorous informal rulemaking standards of 5 U.S.C. 553 were insufficient. The court below, however, found that it was "unnecessary to enter the colloquy" between the *Mobil* court and other courts concerning the minimum procedures required for ratemaking, because the procedures followed by the Commission "went beyond the rudiments of informal rulemaking"(Pet. App. A23, A24).[5] Indeed, the court concluded that the procedures followed by the Commission

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[4]Even when a statute requires that the rulemaking procedure take place "on the record after opportunity for an agency hearing," thus making Section 556 applicable, subsection (d) of that section provides that the agency may proceed by the submission of all or part of the evidence in written form if a party will not be "prejudiced thereby." As the court below correctly held (Pet. App. A25), "[t]he procedures used in setting the national rate neither prejudiced the APGA, nor prevented a full and true disclosure of the facts."

[5]The promulgation of the national rate was preceded by a notice which "clearly indicated that the Commission intended to establish by rule nationwide rates for natural gas " (Pet. App. A23) and "provided for the submission of sworn written comments" (*id.* at A24). More than 80 parties "representing a broad range of consumer and gas industry interests" submitted "sworn testimony and evidentiary data" and were given the opportunity on a second round of submittals to "rebut both Commission and privately-generated evidence" (*ibid.*). Additionally, the Commission held a public conference on the issues concerning possible under-reporting of reserve additions and drilling footages and held two days of oral argument on its proposed orders (*ibid.*; see n. 1, pp. 2-3, *supra.*

"satisfie[d] even the more stringent requirements of the formal hearing process" (*id.* at A25). Thus, the question of what minimum procedures are necessary for ratemaking by rulemaking under the Natural Gas Act and the Administrative Procedure Act—the question before the District of Columbia Circuit in *Mobil*—is not present in this case.[6]

2. Petitioners Associated Gas Distributors (Pet. No. 75-1308, pp. 6-12) and American Public Gas Association (Pet. No. 75-1304, pp. 11-14) contend that the court of appeals applied an incorrect standard in reviewing the Commission's orders. There is no merit to the contention.

In *Permian Basin Area Rate Cases*, 390 U.S. 747, 791-792, this Court held that the responsibilities of a reviewing court were to determine (1) whether the Commission had abused or exceeded its authority; (2) whether each of the order's essential elements is supported by substantial evidence; and (3) whether the order may be expected to "maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests, both existing and foreseeable." Further, the "court's responsibility is not to supplant the Commission's balance of these interests with one more nearly to its liking, but instead to assure itself

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[6]APGA is incorrect in suggesting that Section 1.20(g) of the Commission's regulations, 18 C.F.R. 1.20(g), requires a formal evidentiary hearing (Pet. No. 75-1304, p. 10). Section 1.20(g) governs the "presentation by the parties" when, and if, the Commission determines that a formal hearing is necessary and when it initiates such a hearing pursuant to Section 1.20(a), 18 C.F.R. 1.20(a). Section 1.20(m), 18 C.F.R. 1.20(m), sets forth the procedures to be utilized in rulemaking. Thus, Section 1.20 merely allows the Commission to implement its broad authority to tailor procedures to the needs of particular cases and cannot properly be construed to require the Commission to hold a formal hearing.

that the Commission has given reasoned consideration to each of the pertinent factors" (*id.* at 792). The Commission's orders are, therefore, entitled to a "presumption of validity," and those who would seek to overturn the orders bear "the heavy burden" of showing that the order is "unjust and unreasonable in its consequences" (*id.* at 767).

In *Mobil Oil Corp.* v. *Federal Power Commission*, 417 U.S. 283, this Court emphasized that "application of the three criteria of judicial review of Commission orders is primarily the task of the courts of appeals"; that the "responsibility to assess the record to determine whether agency findings are supported by substantial evidence" is, by virtue of Section 19(b) of the Act (15 U.S.C. 717r(b)) the function of the court of appeals; and that this Court therefore will intervene only in the "rare instance when the standard appears to have been misapprehended or grossly misapplied" (417 U.S. at 309-310).

No such "rare instance" is presented here. The court of appeals correctly apprehended and properly applied the review standards enunciated by this Court in *Permian*. The ultimate issue for the court was whether the "end result" of the order was "unjust and unreasonable," and it resolved that issue by applying the criteria established by this Court in *Permian* (Pet. App. A15-A16). The court was "guided by four elements which delimit the scope of our authority" (Pet. App. A15):

> (i) the well-known statutory "substantial evidence" standard, (ii) a judicially recognized "presumption of validity" * * *, (iii) the longstanding "total effect" test of *FPC* v. *Hope Natural Gas Co.*, 1944, 320 U.S. 591, * * * and (iv) a "zone of reasonableness" to compensate for the necessarily imprecise nature of cost determinations and the inherent difficulty of the regulatory undertaking.

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The court indicated, however, that its "narrow scope of review" was further "tempered" by the experimental nature of area and national rate regulation, which calls for a "heightened deference to the Commission's expertise" (*id.* at A16-A17).

Applying the *Permian* review criteria to each element of the Commission's order, the court of appeals found that the Commission was authorized to prescribe a "national" rate for new gas sales (*id.* at A20-A23) and that each element of the national rate structure—specific cost findings and methodology—was reasonable and supported by substantial evidence (*id.* at A27-A44).[7] Petitioners argue that the court incorrectly afforded the Commission's orders too

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[7]The court below rejected several attacks upon the Commission's cost-based formula raised here by petitioners APGA (Pet. No. 75-1304, pp. 12-14) and Shell Oil Company (Pet. No. 75-1299, pp. 8-11, 15-21): (1) the court found that the Commission's analysis of the evidence leading to a future productivity (the amount of natural gas added to the non-associated gas reserves for every foot drilled) was "supported by the record" (Pet. App. A31-A35); (2) the court found that the parties who had attacked the Commission's use of a discounted cash flow methodology as a supplementary cost analysis had "failed to sustain" their "weighty burden of proof" that the use of such methodology "results in an unjust and unreasonable end result" (*id.* at A37); (3) the court also found the Commission's "policy choice" of excluding an average federal income tax component from the national rate structure, in favor of allowing individual producers to seek extraordinary relief in the form of higher rates when they could demonstrate an "actual income tax liability," was not "so unjust and unreasonable" as to require judicial intervention (*id.* at A37-A39); (4) the court found that the Commission's projections of future lease acquisition costs "are based on substantial evidence and cannot be reversed at this stage" (*id.* at A40); (5) the court additionally held that the Commission's findings regarding the level of the net liquid credit, "a cost equation component of relatively little import," were sufficiently supported by the record (*id.* at A41); and (6) the court held that the Commission did not err in using cost-based ratemaking and in refusing to consider non-cost factors created solely by market forces (*id.* at A44-A45).

limited a review. However, while the "experimental nature" of national rate regulation may have resulted in "heightened deference" to the Commission's expertise, the court below scrupulously examined each element of the Commission's order. Furthermore, this "deference" to Commission expertise in ratemaking orders was a central aspect of this Court's review in both *Permian, supra,* 390 U.S. at 767, 790-792, and *Mobil, supra,* 417 U.S. at 331. The court of appeals correctly concluded that such deference was appropriate here as well, because "national rate regulation is still experimental" (Pet. App. A17).

3. Several petitioners[8] contend that the decision to apply the new national rate to certain renewal contracts for flowing gas was not supported by the record and improperly failed to require recipients to engage in exploration and development. These arguments were correctly rejected by the court of appeals.

(a) Petitioners argue that there is no evidentiary basis to support the allowance of the national rate for sales under new contracts replacing long-term contracts that have expired by their own terms.[9] But the court below found (Pet. App. A29-A30):

> The Commission found from the evidence in the record that a massive commitment of new funds is necessary to alleviate the natural gas shortage and that internally generated sums are a necessary source of such funds. * * * From these facts it reasoned that the national rate structure should be functionally applied to provide some of these funds, placing the burden not

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[8] Public Service Commission of New York (Pet. No. 75-1305, *passim*); Associated Gas Distributors (Pet. No. 75-1308, pp. 6-14); APGA (Pet. No. 75-1304, pp. 14-16).

[9] The Commission found a gross disparity between supply and demand and explained that, if the nation's future need for natural

just on "new" gas but also on flowing gas for which the primary contract had expired.

Petitioners have not shown that the court of appeals has "misapprehended or grossly misapplied" the substantial evidence standard. *Mobil, supra,* 417 U.S. at 310. Moreover, the Commission's use of price functionally to encourage exploration and development, and specifically its determination that the burden of future exploration and development should be borne in part by consumers of flowing gas, were upheld by this Court in *Mobil, supra,* 417 U.S. at 319-321. The specific mechanism chosen by the Commission to accomplish that end in the national rate case—applying the national rate to certain renewal contracts for flowing gas—has been sanctioned by the two courts of appeals that have previously addressed the issue. *Shell Oil Co.* v. *Federal Power Commission,* 491 F.2d 82 (C.A. 5); *Public Service Commission for the State of New York* v. *Federal Power Commission,* C.A. D.C., Nos. 73-1647, *et al.,* decided January 27, 1976, pending on petitions for certiorari, Nos. 75-1556, 75-1565.

(b) Petitioners suggest that even if it is permissible to increase the rate for flowing gas, the Commission erred in not requiring the producers receiving the rate increase to engage in exploration and development. The Commission determined that imposing a specific exploration and development commitment as a condition of a rate increase in replacement contracts was not neces-

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gas was to be satisfied, massive capital commitments were necessary to expand programs of exploration and development (Pet. App. C26-C28). It found that, but for the generation of internal capital through rate relief, the essential expansion of exploration and development would not take place (*id.* at D55-D56). The Commission acknowledged the impact upon the consumer in terms of the increased price of gas supplies (*id.* at D56-D62), but it concluded that the increased consumer cost attributable to higher well-head gas prices was more than counterbalanced by the greater assurance of continued service (*id.* at D60).

sary, believing instead "that by requiring an old contract to be renegotiated before the new rate is recoverable, the pipeline might be able to negotiate for additional acreage dedication to interstate commerce, or exploration and development activity on previously dedicated acreage or other concessions for the price increase" (Pet. App. A29). Petitioners argue that in a time of natural gas shortage the pipeline negotiating a replacement contract will not be in a position to bargain for any increased gas supplies for the interstate market. In essence, petitioners seek to substitute their judgment for that of the Commission, but they have not carried their "heavy burden of making a convincing showing that [the Commission's judgment] is invalid because it is unjust and unreasonable in its consequences." *Mobil, supra,* 417 U.S. at 307, quoting *Federal Power Commission* v. *Hope Natural Gas Co.,* 320 U.S. 591, 602. As the court below correctly concluded, "the Commission has exercised its discretion after considering all pertinent options" and has "reached a well-considered, expert decision on this issue" (Pet. App. A29).

(c) In contrast to the consumer petitioners, Superior Oil Company (Pet. No. 75-1474, pp. 8-17) argues that it was illegal and arbitrary for the Commission to require a newly executed sales contract as a condition of receiving the national rate. Superior contends that the Commission lacks the authority to compel a producer and a pipeline to enter into a contract (*id.* at 10). But the Commission has not required the execution of a contract; nor has it dictated the terms of a contract if one is entered into. Under the Commission's order, the parties remain free to contract or not to contract and to determine the terms of their service contracts. Cf. *Federal Power Commission* v. *Sierra Pacific Power Co.,* 350 U.S. 348; *United Gas Pipe Line Co.* v.

Mobile Gas Service Corp., 350 U.S. 332. The Commission has simply determined that, if a replacement contract is executed, the newly-prescribed national rate should be applicable because of the possibility that the pipeline may be able to bargain for additional acreage dedication, increased exploration and development activity, or other concessions for the rate increase. However, if the national rate were allowed with or without a new contract, a producer would be released from any obligation to bargain with a pipeline, thus eliminating any possibility of a *quid pro quo* for the rate increase.[10]

4. The Commission required producers, as a condition of receiving the national rate for "new gas," to waive their right to utilize such gas to discharge refund obligations and trigger contingent escalations under the incentive provisions of prior area rate orders. Shell Oil Company (Pet. No. 75-1299, pp. 11-15), California Company (Pet. No. 75-1289, *passim*), and Superior Oil Company (Pet. No. 75-1474, pp. 18-25) contend that this requirement is an illegal retroactive modification of prior rate orders.

However, by determining that gas sold at the national rate level cannot be used to take advantage of certain

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[10]Arguments that the requirement of a replacement contract is anticompetitive (Pet. No. 75-1474, pp. 15-17) and unduly discriminatory (*id.* at 17-18) are unfounded. There is no evidence in the record to support these assertions. Furthermore, the objections are premature. As the court below recognized, the Commission has "expressly reserved for consideration in the biennial review the question of whether the pipelines are negotiating in good faith or trying to take advantage of the producer's locked-in position, and whether or not the additional funds generated by the application of the new rate increase 'the level of monies committed to exploration and development programs and the volumes of new gas supplies dedicated to interstate pipelines under long-term contracts' " (Pet. App. A30).

incentive provisions in prior rate orders, the Commission did not retroactively modify those orders. To the contrary, the incentive features of those orders are still operative. Each producer has a choice. He may sell his gas under the national rate structure without refund discharges and contingent escalations, or he may continue to sell at the rates prescribed in the area rate orders and avail himself of the refund discharge and contingent escalation provisions of those orders. In other words, the Commission has done nothing more than provide producers with a new alternative rate system which, as the court below correctly found, "is an exercise of Commission discretion which does not amount to retroactive rate regulation" (Pet. App. A42).[11]

Furthermore, the incentive provisions in the prior area rate orders were designed to operate in conjunction with the prescribed base *area* rate levels. As the Commission said, "the rates established in those opinions were determined to be sufficient to encourage exploration and

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[11]An identical disposition was reached by the United States Court of Appeals for the District of Columbia Circuit in *Moss* v. *Federal Power Commission*, 502 F.2d 461 (C.A. D.C.), reversed on other grounds, No. 74-883, decided March 3, 1976. The court of appeals reviewed the Commission's optional certificate procedure and upheld the provision under which a producer who obtains an optional certificate must waive his right to benefit from any contingent escalations or refund discharges that might be triggered in the area in which his sale under the optional procedure is made. The producers in that case argued, as do the petitioners here, that they were entitled to benefit from the previously established incentives *and* to sell their gas in excess of the area ceiling rate pursuant to the optional certificate procedure. The court there reasoned that in prescribing the optional procedure the Commission had provided an alternative for each producer: "[h]e may dedicate his new gas under the procedure that is most beneficial to him. * * * He may benefit under one procedure but not under both" (502 F.2d at 470). Similarly, under the orders here, a producer may sell his gas at the national rate without the incentives, or at the area rate with the incentives, but not both.

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development activities when coupled with the refund credit incentives and contingent escalations" (Pet. App. C110). To allow new dedications of gas to receive the national rate and, at the same time, discharge refund obligations or trigger contingent escalations would therefore be "an apostasy of the Commission's area rate opinions which adopted the contingent escalations and refund credits as part of a rate structure which included the then prevailing area rates for flowing gas and new gas" (Pet. App. D65).

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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